The Economist

NOVEMBER 29TH–DECEMBER 5TH 2003

Bad times for Boeing
PAGE 57

The Medicare turkey
PAGE 27

Georgia's rose revolution
PAGES 23-26

Worms, viruses and spam
PAGES 65-67

Help at last on AIDS

Yet the worst is still to come

US$4.95 · C$6.95

PRINT EDITION

Full contents
Enlarge current cover
Past issues/regional covers
Subscribe

GLOBAL AGENDA

POLITICS THIS WEEK

BUSINESS THIS WEEK

OPINION
Leaders
Letters

WORLD
United States
The Americas
Asia
Middle East & Africa
Europe
Britain
Country Briefings
Cities Guide

SURVEYS

BUSINESS
Management Reading
Business Education
Executive Dialogue

FINANCE & ECONOMICS
Economics Focus
Economics A-Z

SCIENCE & TECHNOLOGY
Technology Quarterly

PEOPLE
Obituary

BOOKS & ARTS
Style Guide

MARKETS & DATA
Weekly Indicators
Currencies
Big Mac Index

DIVERSIONS

RESEARCH TOOLS

CLASSIFIEDS

DELIVERY OPTIONS
E-mail Newsletters
Mobile Edition
RSS Feeds

ONLINE FEATURES
Cities Guide Go
Country Briefings Go
Audio interviews Go
Classifieds Go

The Economist Group
Economist Intelligence Unit
Economist Conferences
The World In
Intelligent Life
CFO
Roll Call
European Voice
EuroFinance Conferences
Economist Diaries and Business Gifts

Advertisement

Print Edition November 29th 2003

Help at last
Yet, despite better efforts at home and from abroad, the worst death toll from AIDS still lies ahead ... More on this week's lead article

The world this week

Politics this week
Business this week

Leaders

Help at last

American economic policy
Failing on trade

Europe's fiscal follies
Unstable and incredible

Universities
Drowning spires

The housing market
The seven deadly sins

Letters

On America, Arabs and democracy, the beauty business, Nobel prizes

Special Report

The Caucasus
A moment of truth

United States

Medicare reform
The biggest turkey of all?

The economy
Up and away

The sniper trials
Hard Virginia

Imported car factories
Buying jobs can be expensive

Drugs and the heartland
You take the high road

Lexington
Cut from the same cloth

The Americas

Latin America and the United States
Between rivalry and co-operation

Canada
Now let's dig an expensive hole

Colombia's paramilitaries
Forgiving and forgetting

Ecuador's government
A bad, bad trip in Quito

Correction: Canada's defence policy

Asia

China
Trouble on the fringes

Laos
Damned if you do

Japan's economy
Learning to love a growing China

India and Pakistan
A break in the clouds

Bangladesh's religious minorities
Safe only in the departure lounge

Pakistan's North-West Frontier
Making a virtue of necessity

Middle East & Africa

Iran's nuclear secrets

Previous print editions

Nov 22nd 2003
Nov 15th 2003
Nov 8th 2003
Nov 1st 2003
Oct 25th 2003

More print editions and covers »

Subscribe

Subscribe to the print edition
Or buy a Web subscription for full access online
RSS feeds
Receive this page by RSS feed

Business

Corporate scandals
Where's Boeing going?

Offshoring
Lost in translation

Music
Better luck this Time?

Business in Iraq
Number unobtainable

Mobile telecoms
Much ado about porting

The toy business
Grinched

Biotech in Cuba
Truly revolutionary

Deregulation in Japan
Tilting at windmills?

Face value
India's turn-round queen

Special Report

Internet security
Fighting the worms of mass destruction

Finance & Economics

Investment banking
Sound and fury

The Executive Life affair
Come on, Jacques

Takeovers in Europe
Lowest common denominator

German Landesbanks
Deep impact

Japanese banks
Skin deep

Entertainment finance
Star-struck

Property prices
Shaky foundations

Economics focus
Stop worrying and love the deficit

Correction: foreign-currency scam

Science & Technology

AIDS
A mixed prognosis

AIDS and the Middle East
Lifting the veil

Books & Arts

American political history
A paean for Roosevelt

The war in Iraq
An elusive peace

Chiang Kai-shek
A Chinese enigma

Literary biography I
Simply Yeats

Coaxing Iran to come clean

Human rights in Iran
Small mercies

Iraq
Dangers of the inquisition

Games in Iraq
The ancient art of deception

Israelis and Palestinians
A silent, moderate majority

Kenya, corruption and the IMF
Dirt out, cash in

Award

Europe

Europe and the euro
The death of the stability pact

Turkey after the bombings
An Islamist facing Islamic terrorism

Croatia
Backlash

Remembering Yugoslavia's war
Twelve years on

French universities
Elite syncopations

The trials of Italy's prime minister
One down

Charlemagne
Those pesky Poles

Britain

Universities
Dons bring in the dough

Longevity
Dons' delight

Whisky
Storm in a whisky barrel

The left
George's big adventure

The BBC
A monitor for the Middle East

Constitutional reform
Lords behaving badly

Railways
What price safety?

Retailing
Christmas at the checkout

Carmakers
Take less, give more

Bagehot
The listening prime minister

Articles flagged with this icon are printed only in the British edition of *The Economist*

Literary biography II
Writings on a marriage

Eurojazz
Curiosity road

Obituary

Canaan Banana

Economic and Financial Indicators

Overview

Output, demand and jobs

Prices and wages

GDP forecasts

Money and interest rates

The Economist commodity price index

Stockmarkets

Trade, exchange rates and budgets

The Economist food index

Emerging-Market Indicators

Overview

Digital access index

Economy

Financial markets

Advertisement

Classifieds

Jobs
Governance Fellow on Security and Development (Ref 159)
This is an exciting opportunity to join one of the world's ....

Business / Consumer
WSI Internet - Start Your Own Business
Business Opportunity - WSI Internet Start Your Own Busines....

Tenders
Requests Expressions of Interest for The Development of a New Lignite Mining Facility and Associated New Electric Generating and Transmission

Jobs
Marketing Associate Needed
Marketing Associate Provide analytic support to the Global Product Strategy Group Respo....

Tenders
Republic of Ghana Ministry of Trade, Industry, PSD & PSI - Request for Expression of Interest: Preparation of Competition Bill for Ghana

Jobs
Regional Director Balkans
Job Profile Our Regional Director Balkans (based in Tirana), leads and mobil....

Sponsors' feature About sponsorship »

Copyright © The Economist Newspaper Limited 2006. All rights reserved. Advertising Info | Legal disclaimer | Accessibility | Privacy policy | Terms & Conditions | Help

Produced by =ECO PDF TEAM=
Thanks xxmama

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Politics this week

Nov 27th 2003
From The Economist print edition

Caucasian velvet

AP

After protesters had stormed **Georgia's** parliament to demand fresh elections, Edward Shevardnadze resigned as the country's president. The main opposition parties have named Mikhail Saakashvili, who orchestrated the protests, as their joint candidate to replace Mr Shevardnadze in presidential elections to be held on January 4th.

See article: At a crossroads in the Caucasus

Overruling the European Commission, eight countries voted to let **France** and **Germany** escape penalties for their breach of the budget-deficit ceilings of 3% of GDP set under the euro area's stability and growth pact. The commission, several small countries and the European Central Bank all railed at this flouting of the rules.

See article: Unpicking the fiscal straitjacket

The Italian government, as president of the European Union, published its latest draft of a new **EU constitution**, including a proposal for some majority voting on foreign policy. Britain and others seem unlikely to accept that.

The Democratic Union Party (HDZ) swept back to power after demolishing the centre-left governing coalition in **Croatia's** parliamentary elections. The HDZ claims that it has abandoned the hardline nationalism it preached under its former leader and the country's past president, Franjo Tudjman.

See article: The return of the nationalists

A former leader of the **Croatian Serbs**, Milan Babic, unexpectedly appeared at the war-crimes tribunal in The Hague. Mr Babic, “prime minister” of the breakaway Serb Krajina republic until 1995, was indicted in mid-November, but nobody knew where he was until this week.

A fire at a hostel for foreign students in **Moscow** killed 36 and left some 200 injured. The building lacked a fire alarm and adequate fire escapes.

See article: Dormitory tragedy

Gun silencer

The **Indian** and **Pakistani** armies began a ceasefire across the “line of control” that divides the disputed state of Kashmir and the Himalayan glacier of Siachen. The truce is the first formal ceasefire between the nuclear-armed rivals since an insurgency began in Kashmir 14 years ago.

See article: A ceasefire in Kashmir

South Korea's president, Roh Moo-hyun, vetoed a bid by the opposition-controlled parliament to investigate a political-funding scandal involving one of his closest aides. The leader of the opposition Grand National Party began a hunger strike in protest.

China suspended 673 state-run newspapers, part of sweeping press reforms aimed at bringing the industry in line with a free-market economy and reducing government spending.

See article: Democracy worries China

Myanmar's military government released five senior opposition politicians from house arrest. All five are members of Aung San Suu Kyi's National League for Democracy. But the opposition leader herself was not freed.

England became the first country from the northern hemisphere to win the **Rugby Union world cup**, after beating Australia in the final in Sydney.

AP

See article: Swimming with the sharks

Sick benefit

The American Congress passed the most significant changes to **Medicare**, the health-insurance programme for the elderly and the disabled, since its inception in 1965, making prescription drugs cheaper for participants. The passage of a controversial energy act was temporarily halted: it will be put to the vote again when Congress reconvenes in January.

See article: Medicare reform gets through Congress

President George Bush said the American armed forces were facing a “great and historic task” in confronting **terrorism**. He spoke at a bill-signing ceremony that authorised $401 billion for defence. Meanwhile, the FBI wrote to the *New York Times* to deny that it was using anti-terrorism laws to gather intelligence on anti-war protesters.

The jury in the trial of John Allen Muhammad recommended the death penalty for the convicted **Washington sniper**. Mr Muhammad's lawyers are expected to appeal; he is the first person to be convicted using Virginia's newly enacted anti-terrorism law.

See article: The sniper trials

Turning off trouble

The interim leadership in **Iraq** banned an Arabic television station, accusing it of inciting violence against the coalition. A big gas pipeline was blown up in northern Iraq, but Iraq's oil output is now close to pre-war levels.

See article: Iraq's inquisition

The UN nuclear watchdog, the International Atomic Energy Agency, passed a resolution censuring **Iran** over its nuclear programme, but stopped short of recommending sanctions.

See article: One last chance

Israel expelled three suspected Palestinian militants from the West Bank to Gaza. The expulsions came as Israel's leader, Ariel Sharon, said he was considering taking “unilateral steps” to advance the peace process with the Palestinians. America said it would withhold $290m in protest at the “security fence” Israel is building deep into the occupied West Bank.

See article: Reasonable Israelis and Palestinians

The IMF resumed aid to **Kenya** after a three-year gap, extending a $253m loan to reward the government of President Mwai Kibaki for trying to tackle corruption. Other donors may follow.

See article: Donors come back to Kenya

Nigeria said it would hand over to Liberia its former president, Charles Taylor, if that country wanted to try him for war crimes.

A UN report said that a serious effort was at last being made to tackle **AIDS**, but that it was still “entirely inadequate”. AIDS is spreading rapidly in parts of Asia and eastern Europe and remains catastrophically common in sub-Saharan Africa. An estimated 40m people worldwide are now infected with HIV.

See article: Help at last on AIDS

Mostly armless

EPA

In **Colombia**, 800 right-wing paramilitary militiamen laid down their weapons as part of a government-sponsored peace process. Human-rights groups claim that the scheme will allow war criminals and drug traffickers to escape punishment.

See article: Colombia's paramilitaries

Ecuador's president, Lucio Gutiérrez, denied allegations that his aides accepted $30,000 from the family of a drug trafficker during his election campaign last year. The country's Congress is investigating the charges.

See article: Ecuador's government in a fix

In **Mexico**, the leaders of the Institutional Revolutionary Party (PRI), the largest in Congress, disagreed in public about whether or not to work with President Vicente Fox's government on plans to raise taxes on items such as food and medicine.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Business this week

Nov 27th 2003
From The Economist print edition

Music to their ears

Investors led by **Edgar Bronfman** successfully outbid Britain's EMI for **Warner Music**. Time Warner accepted the media mogul's offer of $2.6 billion for its music business, almost twice the sum offered by EMI. The British firm must now look elsewhere for a partner to beef up its business.

See article: Gambling on music

American legislators passed a bill designed to combat **spam**. Spammers will be required not to disguise their identities or use false return addresses; a “do not spam” register was authorised. Bill Gates hailed the initiative as a “milestone”; critics noted that it covered only American firms and insisted it would encourage more spam by laying down easily-met criteria for sending the irritating e-mails.

See article: Internet security

America's **mobile-phone** industry braced itself for more intense competition as customers won the legal right to keep their phone number when they change operator. But early customer reaction was muted.

See article: Phone number portability in America

H.J. Heinz, the world's leading ketchup-maker, said that profits in the latest quarter were down by 10% compared with a year ago to $192m. The fall reflects the spin-off of underperforming units: off the menu went tuna fish, soup, and pet and baby food.

Boeing, Boeing, gone

Boeing sacked Mike Sears, its chief financial officer, and Darleen Druyun, an employee formerly with the US air force, for improper dealings over contracts for military aircraft. Ms Druyun got a job with the aircraft-maker after involvement with negotiating a contract for tankers with Boeing. Mr Sears is accused of discussing future employment with her while the deal was progressing. He denies violating company policy.

See article: Problems for Boeing

Leo Mullin, chairman and chief executive of **Delta Air Lines**, announced that he would step down at the beginning of next year. His recent efforts to negotiate wage concession with pilots at America's third-largest airline were hampered by controversy over executive pay deals.

Between the banks

Citigroup paid $1.3 billion for the consumer-finance arm of **Washington Mutual** to extend its reach in retail lending. **Independence Community Bank**, a New York bank, agreed to pay some $1.4 billion in cash and shares for **Staten Island Bancorp**.

See article: Investment banking

Munich Re, the world's biggest reinsurer, said that it would make its first annual loss since 1906 despite

announcing profits of *euro*152m ($171m) in the third quarter. Its shares plunged.

Accused

Regulatory probes into improper trading at American mutual funds claimed a first corporate fatality. **Security Trust** was ordered to close by the Treasury Department after criminal and civil charges were brought against three executives for facilitating “late trading” by hedge funds.

The **London Stock Exchange** decided to continue using the London Clearing House as a clearer of trades. It rejected overtures from Eurex, a German-Swiss derivatives exchange and clearer.

UBS, Switzerland's largest bank, sacked two employees in America and suspended another nine after an internal inquiry into the improper trading of mutual funds.

The jury in the trial of **Dennis Kozlowski**, accused of looting $600m from Tyco, were shown details of where $30m of the industrial conglomerate's cash went: Mr Kozlowski's luxury flat. Furnishings included hand-painted wallpaper, masterpieces by Monet and Renoir, and a $6,000 shower curtain for the maid (herself on Tyco's payroll at $70,000 a year plus bonuses).

Switching off trade

Trade relations between **America** and **China** worsened further after the Commerce Department imposed anti-dumping duties on televisions from four Chinese firms. A week earlier America restricted the import of Chinese bras and other textiles. Meanwhile, **Japan** threatened retaliation against American steel tariffs that the World Trade Organisation has ruled illegal.

See article: George Bush is making a hash of trade

America's rapid economic growth in the third quarter was revised upwards by one percentage point to a blistering 8.2% at an annual rate, the sharpest rise in 20 years. The outlook for America's economy is particularly rosy; consumer confidence also rose to its highest level for a year in November.

See article: The economy revs up

The **world's economies** will pick up over the next two years with America leading the way, according to the OECD's *Economic Outlook*. Despite the recovery, the organisation said that unemployment would remain high. It also cautioned that America's burgeoning current-account deficit would depress the dollar further, but that a sudden drop could dent Europe's recovery.

See article: GDP forecasts

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Help at last

Nov 27th 2003
From The Economist print edition

Yet, despite better efforts at home and from abroad, the worst death toll from AIDS still lies ahead

REX

Get article background

A DECADE and a half ago, informed South Africans were fretting about AIDS. Fewer than 2% of their compatriots were then infected with HIV, the virus that causes AIDS, but epidemiologists looked at the way AIDS was devastating the rest of Africa, and figured that South Africa was probably next. One of them, Alan Whiteside, predicted in 1990 that by 2001, more than a million South Africans would have the disease. Neither the apartheid regime nor the democratic government that replaced it took such warnings seriously. As late as 1998, when a fifth of South African adults were infected, not one billboard in Johannesburg alerted passers-by to the dangers of unprotected sex. Because no one heeded the prophets of doom, their predictions came true, and then some. Today, South Africa has more HIV positive citizens than any other country: 5.3m, out of a population of 45m.

As this example illustrates, delay can spell disaster when dealing with AIDS. By the gloomiest recent projection, South Africa is heading for an economic collapse within three generations, as wage-earners are wiped out and parents die before they can teach their offspring the basics of how to get on in life. Thankfully, the chance of this awful scenario coming to pass was reduced last week, when the South African government unveiled a serious, well-funded and long-term plan for treating its sick citizens with anti-retroviral drugs. If the plan is competently implemented, HIV positive parents should survive long enough to put their children through school, and South Africa should pull back from the brink of catastrophe.

Finally, more money

The rest of the world is also starting, at last, to take AIDS seriously (see article). Much more cash has been made available to fight the disease. Donors and developing-country governments between them stumped up $4.7 billion this year—23 times the total in 1996. More is needed: UNAIDS, the UN body that monitors the pandemic, wants to see $10 billion spent in 2005 and $15 billion in 2007.

Some of this money will be found: most donors have promised to chip in, and a few forward-thinking private companies have started to treat their infected workers. At least as important as the sum raised is the question of how it is spent. The good news is that an increasing number of poor countries have devised plausible national plans for tackling the disease. The bad news is that some donors, particularly

the largest, America, attach too many strings to their gifts. The Bush administration withholds family-planning money from groups that “promote” abortion. This causes needless trouble for reproductive-health organisations, whose contribution is essential to combat AIDS. Mr Bush is also hesitant to fund some multilateral initiatives, such as the Global Fund to Fight AIDS, Tuberculosis and Malaria. This is a shame: the Fund is good at finding out what recipient countries need, and distributes cash efficiently. If donors all gave bilaterally, recipients would have to waste time jumping through multiple hoops.

The price of AIDS drugs has plummeted by more than 95% in the past few years. Until recently, it was taken for granted that HIV positive poor people were doomed, and that everyone should concentrate on persuading those who were not yet infected to shun risky sex. Now, the talk is of how quickly drugs can be distributed to all who need them. This is wonderful, but there are snags.

First, distributing drugs in Africa, where the need is greatest, will be difficult, as the continent's health-care infrastructure is appalling. Second, although middle-income countries such as South Africa, Botswana and Brazil can fund their own drug programmes, the poorest cannot. As donors step into the breach, these countries will grow worryingly dependent—a cut in aid could mean mass death and, perhaps, civil unrest. Finally, when resistance develops to today's pills—as it surely will—new ones will be needed. This is where drug firms normally come in. The trouble is that the recent price reductions were achieved through an aggressive campaign by activists promoting generic copies of patented pills. This has reduced corporate incentives to invent new AIDS medicines.

For those who will be helped

None of these problems is insuperable. Understaffed health systems can be pepped up by, for example, getting nurses to do tasks that doctors usually would, and training a few people in each village to show others how to take their pills. Aid dependency might matter less if donors could make long-term commitments, and offer more debt relief. To ensure that new drugs are developed, it is essential to preserve drug firms' patent rights in rich countries, so that they can recoup their vast investment. To develop drugs appropriate for the world's poorest victims, public money for drug research is needed too.

Since HIV was first discovered in the early 1980s, the epidemic has mutated. At first, the stereotypical sufferer was wealthy, white and gay. Now, the largest group is of African women. Ten years from now, who knows? Epidemics can explode suddenly. The UN frets that several countries may be sleepwalking into calamity. Russia, for example, has a big and growing problem but cannot even get round to testing people properly. There are also worrying signs of complacency in the world's two most populous countries. In some high-risk groups in India HIV prevalence is as high as 5%, and China has pockets of high infection, too. Almost everywhere, the stigma of AIDS, besides prompting people to mistreat its victims, also deters them from getting tested, and deters capable and respected figures from joining the struggle to curb the disease.

Governments everywhere should look at Africa and tremble. In some countries, more than half the population will still die of AIDS. All of Africa's famines are now AIDS-related: hungry people lack the strength to fight off sickness, sick people lack the strength to grow food, and dead parents cannot teach their children how to farm. Other regions can avoid this, but they must act now. The rewards will come slowly; it will be years before current investments make a dent in HIV prevalence, let alone the death rate. The worst is yet to come.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

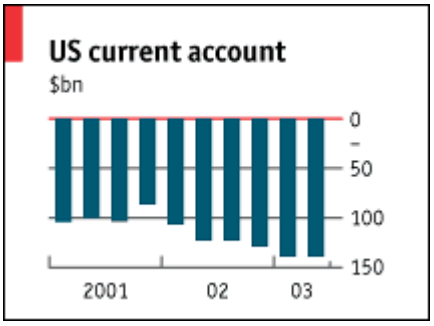
American economic policy

Failing on trade

Nov 27th 2003
From The Economist print edition

Trade policy is fast becoming one of George Bush's biggest failures. What can he do about it?

Get article background



FROM the outset, the Bush administration set itself ambitious goals for trade policy. Dedicated to the cause of liberal trade, it enunciated a strategy of "competitive liberalisation"—of opening markets on every available front, by means of multilateral negotiations at the World Trade Organisation (WTO), through regional deals such as the Free Trade Area of the Americas (FTAA), and through bilateral agreements struck with individual countries. None of these routes would be given undue priority. Instead, use every avenue. Only one question would matter: does it work?

The trouble is, it didn't. The WTO is floundering, with the Doha round of negotiations in suspended animation since the collapse at Cancún. Talks on the FTAA have not actually broken down, but a chill has descended, and there is little progress to speak of (see article). As for bilateral agreements, even supposing they do not distort trade flows (a big assumption), the administration's agenda boils down to a cluster of deals with countries that pose little or no competitive threat to American producers.

Far from advancing on every front, the administration's foreign economic policy is thus stalled, at best, on every front. And this is to say nothing of America's steel tariffs, ruled illegal by the WTO and now likely to face protectionist retaliation by the European Union and others; or the so-called safeguard quotas imposed last week on selected imports of textiles from China, which may well provoke trade retaliation.

Failure is really too kind a word for this squalid mess. Some may defend the policy as an instance of robust unilateralism, but the failure of the administration's multilateral and regional initiatives was not a price that had to be paid to defend America's interests: on the contrary, those failures directly harm the American economy. The failure to reform the farm-support regime as part of the Doha process hurts far more Americans than it helps. The steel tariffs hurt most Americans—as the growing complaints from America's industrial consumers of steel attest. The quotas on Chinese textiles hurt most Americans. In all this, America has gained nothing, and lost much; unless the rot is stopped, it will lose a lot more.

The United States is certainly not the principal country at fault. The European Union and some of the developing countries deserve most of the blame for the collapse at Cancún, for instance. But America, unlike the rest, can plausibly hope to restart those talks by taking the initiative with a generous new offer on farm trade—one that it and the world should then insist Europe matches. And the White House can also help to restore the momentum of trade reform by reversing itself on the steel tariffs. Let it claim that the tariffs are no longer needed now the economy is growing more robustly.

In the longer run, the administration needs to remind itself of the case for free trade, and then put that case to the public. (It ought to be ashamed that the Clinton administration did this more bravely.) It should give priority to the WTO, because that is where big deals can be done—deals which offer something to everyone and thereby oil the wheels of domestic politics. And it should look again at the domestic policies that support freer trade: notably, measures to assist workers whose jobs are displaced by import competition.

None of this will be easy in an election year. The easy thing will be to carry on making a hash of it. For America's sake, and for the world's, the president should aim higher.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Europe's fiscal follies

Unstable and incredible

Nov 27th 2003
From The Economist print edition

Now that the "stability and growth pact" is defunct, what should replace it?

THE death throes have been painfully drawn-out. But this week, at long last, Europe's finance ministers have killed the ill-named "stability and growth pact". The pact, memorably dubbed "stupid" by the European Commission's president, Romano Prodi, supposedly limited budget deficits for euro members to no more than 3% of GDP, on pain of fines as big as 0.5% of GDP. By 2005 both France and Germany will have exceeded the 3% ceiling for four years running. And yet, to the disgust of the commission and a handful of indignant small countries, the French and the Germans have persuaded their fellows to let them off the hook. Nobody failed to see the irony that it was Germany which, in the late 1990s, had insisted on a rigid stability pact as its price for accepting the euro.

The battle is not quite over, as the commission and some smaller countries are threatening legal action (see article). But the assumption must be that all sanctions under the stability pact are now a dead letter. Despite this, the "excessive-deficit procedure" that lays down the rules is likely to be included unchanged in the EU constitution due to be agreed next month. Even by the insane standards of Brussels, that makes no sense. Instead, having tried the rules and—as many, including this newspaper, long predicted—found them wanting, governments should now devise a new regime for fiscal policies.

One possibility would be simply to amend the ceiling on budget deficits, for instance raising it to 4%, or varying it according to countries' positions in their economic cycles. Most economists agree that it would have been foolish in the extreme for France and Germany, both just emerging from near-recession and both suffering from a strong euro, to tighten their fiscal policies any further at this point. But the trouble is that even a higher ceiling would remain just as arbitrary as today's 3%. Changing the figure to take account of the cycle would make more sense, but it would introduce a complex and disputable new calculation, with countries arguing endlessly over precisely where they were in the cycle.

A better idea would be to scrap the stability pact altogether. After all, a monetary union takes away its members' discretionary control over monetary and exchange-rate policies. Arguably, therefore, they need more, not less, fiscal freedom. And, as the European treaties make clear, national governments are responsible for their own debts: any bail-outs by the European Central Bank (ECB) are explicitly banned. So if a country were to borrow too much, or even to be threatened with bankruptcy, that should be a problem for it and its creditors alone. Financial markets could then be trusted to administer the necessary discipline on excessive deficits, by pushing up interest rates on an errant government's debt.

It all sounds eminently sensible. Yet it may not be wholly realistic. If any member of the euro went bust,

it is hard to imagine that others would stand by unmoved—just as it is hard to imagine the American federal government ever letting a big state go under. That is one reason why 49 of the state constitutions ban budget deficits (although, as California shows, such bans can be circumvented). Moreover, any country that became overly indebted might start to agitate for higher inflation to erode the burden. And there is a potential free-rider problem: if Germany, say, ran large budget deficits, the markets might spread the pain of higher interest rates to all countries in the euro—rather as happened in Europe's then exchange-rate mechanism after German unification in 1990.

A European IMF

In practice, markets seem to assume that no euro member would ever be permitted to go bust. That means that all members have a legitimate interest in each other's fiscal policies. Yet, as the short-lived experience of the stability pact has shown, any notion of sanctions against excessive borrowers is wholly misconceived, because such measures will never be allowed to bite. The answer is to junk sanctions and rely instead on some kind of mutual surveillance that draws the attention of markets (and voters) whenever a country gets on to a dangerously unsustainable path. The focus of such surveillance should not be annual budget deficits but levels of public debt and, even more crucially, of such implicit off-the-books obligations as future pensions and health-care costs.

The force of any such surveillance will depend a lot on who is the watchdog. The commission is one candidate, but it has been discredited by the death of the stability pact, is prone to political influence, and no longer carries credibility. A better choice, despite its quixotic support for the present pact, might be the ECB, which could play a role rather like that of the International Monetary Fund. It would be important to restate, yet again, that the ECB can never bail out a national government. But getting it to utter loud fiscal warnings would surely concentrate markets' minds. It might even deter profligate governments: certainly more so than a toothless stability pact.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

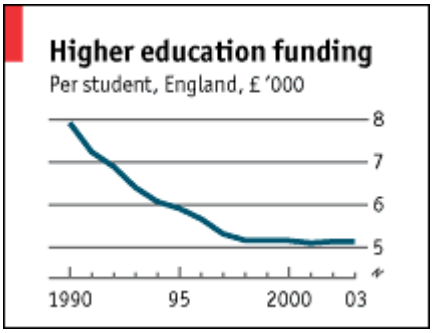
Universities

Drowning spires

Nov 27th 2003
From The Economist print edition

Britain's universities are poor and homogenous. Let them get richer and more various

Get article background



IF THE British government succeeds in pushing a new law on tuition fees through Parliament, good universities will charge more than bad ones. The result, say the scheme's numerous critics, will be a "two-tier system". This newspaper shares their concerns, but for different reasons. Two tiers are not nearly enough. Higher education should have countless tiers, reflecting a huge number of choices.

Britain's universities are increasingly overcrowded, shabby and demoralised places, living on the financial and intellectual investments of the past. Academic salaries are low, teaching scanty. That is because British universities are very short of money. Student numbers have risen sharply, without a matching increase in funding from either government or the private sector. Britain spends just 1% of GDP on tertiary education (most of it state subsidy) compared with 2.7% in America (most of it private money).

Any idea that the taxpayer will fill the gap is fantasy: a school system where a quarter of the children, mainly from poor families, leave primary school barely able to read or write, has a much better claim to more money than higher education. Higher fees are the only likely source of new money. So the government wants to increase universities' income by getting people to repay the cost of their education once they are earning. The bill to introduce this change is the most contentious bit of the government's new legislative programme outlined this week in the Queen's Speech.

The main defence of the current system is fairness: everybody gets the same sort of chance to do the same sort of degree. A market in higher education, critics say, will benefit the rich and hurt the poor, who already fare worst.

Fears for tiers

That criticism is wrong on two counts. First, the government's scheme should not put off the poor. Fees are not payable up front. The state will reclaim them through the tax system after graduation—once the graduate is earning a proper salary. A similar system in Australia has not deterred poor students. It is Britain's current system that is unjust: it hands out taxpayers' money mostly to the well-off, not to the poor. Under the new scheme, rich families will contribute more, while the poor will pay only if they do well after leaving university.

Second, treating everybody the same is not a virtue. People are different, and they want different things from higher education. At present, universities charge exactly the same—£1,125 ($1,900)—per student. More independence would allow them to offer courses of variable depth, length and cost—and thus a many-tiered system.

The problem with the government's scheme is not that it violates sacred principles, but that it is not radical enough. The proposed maximum fee, of £3,000, which will stay frozen until 2011, is far too low. It will make only a trivial difference to most university coffers. And it does not give universities enough scope to differentiate themselves. A survey this week suggests that the vast majority of universities are planning to charge the full £3,000, for fear of being seen as second-rate.

Another damaging bit of watering down is the proposal to divert a large chunk of the extra revenue into bursaries for poor students. But universities are not equipped to means-test applicants. Anyway, one of the attractions of the loans scheme is that low earners never have to pay fees. Worries about access for the poor would be better addressed by widening the loans scheme to cover living costs as well as fees.

Still, the plan is a move in the right direction. If it is defeated, universities face a choice between continued decline on the one hand and cutting undergraduate teaching and boosting the intake of lucrative overseas students and post-graduates (see article) on the other. This would encourage an idea which is gaining momentum among the better universities—that they should break free from government control altogether. They could then charge much higher fees, deliver first-rate teaching, and run their affairs without constant interference. It would be messy, but better than slow starvation.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The housing market

The seven deadly sins

Nov 27th 2003
From The Economist print edition

It is time to expose some popular fallacies about buying a home

IN 1929 John D. Rockefeller decided it was time to sell shares when even a shoe-shine boy offered him a share tip. During the past week *The Economist*'s economics editor has been advised by a taxi driver, a plumber and a hairdresser that "you can't go wrong" investing in housing—the more you own the better. Is this a sign that it is time to get out? At the very least, as house prices around the world climb to ever loftier heights (see article), and more and more people jump on to the buy-to-let ladder, it is time to expose some of the fallacies regularly trotted out by so many self-appointed housing experts.

One common error is that house prices must continue to rise because of a limited supply of land. For instance, it is argued that "house prices will always rise in London because lots of people want to live here". But this confuses the level of prices with their rate of change. Home prices are bound to be higher in big cities because of land scarcity, but this does not guarantee that urban house prices will keep rising indefinitely—just look at Tokyo's huge price-drops since 1990. And, though it is true that a fixed supply of homes may push up house prices if the population is rising, this would imply a steady rise in prices, not the 20% annual jumps of recent years.

A second flawed argument is that low interest rates make buying a home cheaper, and so push up demand and prices. Lower interest rates may have allowed some people, who otherwise could not have afforded a mortgage, to buy a home. But many borrowers who think mortgages are cheaper are suffering from money illusion.

Interest rates are not very low in real, inflation-adjusted terms. Initial interest payments may seem low in relation to income, but because inflation is also low it will not erode the real burden of debt as swiftly as it once did. So in later years mortgage payments will be much larger in real terms. To argue that low nominal interest rates make buying a home cheaper is like arguing that a car loan paid off over four years is cheaper than one repaid over two years.

Fallacy number three is a favourite claim of Alan Greenspan, chairman of America's Federal Reserve. This is that price bubbles are less likely in housing than in the stockmarket because higher transaction costs discourage speculation. In fact, several studies have shown that both in theory and in practice bubbles are more likely in housing than in shares. A study by the IMF finds that a sharp rise in house prices is far more likely to be followed by a bust than is a share-price boom.

Safe as houses?

Another curiosity is the popular claim that investing in property is safer than buying shares, for bricks and mortar are here forever. But that says nothing about relative value. Buy at the peak of a property bubble and your investment is not "safe". To an investor, the value of a house also lies in the rents that a property can generate. If your tenant unexpectedly moves out, you will suddenly find that your income drops to zero.

This leads to a fifth falsehood: it is always better to buy a house, because "paying rent is money down the drain". Thanks to a growing glut of rental properties in many cities, from Sydney to London, the cost of renting is currently cheaper than the cost of paying a mortgage. Only if (a big if) prices continue to

rise does buying always make sense.

Myth number six is that, even if houses are overvalued, their price is unlikely to fall because interest rates will not rise to the double-digit rates that burst previous housing bubbles. Again, the experience of Japan suggests that prices can fall without a big increase in interest rates. All that is needed is a change in sentiment. First-time buyers may balk at sky-high prices, for example, or if rents fall and prices stop rising investors may sell as their expectation of capital gains disappears.

The seventh fallacy is to believe that, even if prices have overshot, they will not fall, but just level off. When inflation was high, real house prices did indeed adjust in this way. But, if inflation remains at 1-2%, it will take years for real house prices to return to normal levels. So today prices are more likely than ever to fall in nominal, as well as real, terms.

Each of these seven arguments may contain a small grain of truth in certain circumstances, but they should never be the articles of faith they have become. The more often they are invoked, the greater the risk that prices are headed for a crash.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Letters

Nov 27th 2003
From The Economist print edition

The Economist, 25 St James's Street, London SW1A 1HG
FAX: 020 7839 2968 E-MAIL: letters@economist.com

Exceptional America

SIR – There is nothing either mysterious or nefarious about what your survey calls American "exceptionalism" (November 8th). Rather, America warrants attention because, in an age of globalisation with borders disintegrating, it is fast becoming the headquarters nation. What is remarkable about our age is the inexorable if unsteady advance of freedom of all kinds—free movement of trade, people and information. Everything and everyone gravitates towards America because it is the one place that facilitates and welcomes all those freedoms. So each year, America looks more like the world.

As an economic policy it is pretty good; we are packing the educated classes and the value added into our corner of the world, but it is not the result of any studied intent. Rather, it is the natural consequence of our being the only big nation founded not on race, ethnicity or religion, but on ideas—free will, free people and free enterprise. What you call American exceptionalism is rather the triumph of the human spirit of opportunity and hope. These are universal values, and it is only in explicitly embracing and enabling them that our country is, blessedly, exceptional. You're welcome.

Richard Sybert
San Diego, California

SIR – You neglect to mention sport, which is surely the most obvious example of American exceptionalism. Americans are hostile to sports that the rest of the world likes, such as soccer and cricket. There is some evidence that George Washington played cricket with his troops in the revolutionary war but in the 19th century—perhaps as a result of Britain's attack on Washington, DC, in 1814—we Americans became hostile to "foreign" sports. That hostility remained throughout the 20th century and was never questioned, even in the 1960s, the decade when supposedly we questioned everything.

After that came the culture wars, and both sides have tacitly agreed that sports will not be part of the debate. Neither the Eurocentric right nor the multicultural left want to abandon the Americentric environment in which baseball, American football and basketball flourish at the expense of foreign sports. In the 1970s, some of us turned to soccer, but those who did so are not those one might expect. The term "soccer mom" (rather than, say, "soccer liberal" or "soccer leftist") indicates suburban families and not urban multiculturalists.

John Pepple
Gambier, Ohio

SIR – You cite John Winthrop's quote that America is a "city on a hill", a figure of speech often used by, among others, Ronald Reagan. It is worth noting both that Winthrop made the speech containing this quote to his Puritan brethren on board a ship fleeing Europe en route to Massachusetts and that the quote harkens directly to the Sermon on the Mount. The quote not only reflects a sense that America occupies a special place in the world but also a responsibility to aspire to do good and not hide one's light under a bushel. The quote is often cited as an exhortation to communal responsibility and as a reminder that any special favour entrusted should not be squandered.

John Lawlor
Chicago

SIR – Surely you realise that September 11th was not “the first [strike] on the country's mainland by a foreign enemy.” What of the British burning Washington, DC, in 1814?

Peter Salus
Austin, Texas

SIR – You note that in some states, judges are elected. This is just the tip of the decentralised electoral iceberg. While travelling in rural Kentucky last summer, I was astounded to see posters inviting locals to vote for their next jailer.

Rob Carter
Chapel Hill, North Carolina

Governing Arabs

SIR – It may be good for middle-class western consciences to fulminate about democracy in the Arab world but a strong dose of realism might be more useful (“They say we're getting a democracy”, November 15th). Most Arab states have boundaries that are purely the creation of western imperial powers. They contain tribes with ancient antipathies and irreconcilable religious differences.

Also, Islam does not contain any teaching which recognises a higher authority, secular or otherwise, than the Koran. In these circumstances a less exalted form of government, but one which recognises these differences in the community, would have a better expectation of delivering the things that matter most to people wherever they are: housing, jobs, security, and food and clean water.

Paul Harris
Sydney, Australia

SIR – Your appraisal of the French attitude in 1992, when the democratic process was halted in Algeria, is difficult to understand. Democratic elections are designed for parties who share democratic values and not for those who only use them to take power not to give it back later. The Islamic Salvation Front was no democratic party.

Do you think that Algerians would have benefited from this painful experience (and maybe a civil war of the kind they got afterwards)? Do you think that establishing another Islamic republic by democratic methods would have fostered democracy in other Arab countries? Do you really think that a secular regime would have followed?

Christophe Mallet
Paris

Remodelling history

SIR – Your coverage of the beauty business was interesting but your brief historical background of the “cosmeceuticals” business overlooks the person who got the ball rolling (“Skin deep”, November 8th). Erno Laszlo, a Hungarian, studied at the Royal Hungarian Elisabeth University of Medical Sciences in Budapest and went on to Berlin where he studied further under Professor Max Joseph, the father of modern dermatology.

In 1927, he opened the Erno Laszlo Institute for Scientific Cosmetology in Budapest. Ten years later he visited Hollywood where he met Gaylord Hauser, a health guru, and in 1939 he opened the Lazslo Institute on Fifth Avenue in New York. Here his client list included the Duchess of Windsor, Greta Garbo, Lillian Gish, Paulette Goddard and Marilyn Monroe as well as a host of more modern celebrities. Dr Lazslo died in 1973, at the age of 82.

Herbert Hardwick
Chicago

Nobel sentiments

SIR – We are happy and flattered by Philippe Kohler's praise (Letters, November 22nd). But we must take exception to his suggestion that Paul Krugman is less deserving of a Nobel prize. In the research

phase of his career, Mr Krugman contributed many important insights to economics.

We also believe that valuable contributions to policy should increase, not decrease, one's eligibility for the Nobel prize in what is after all a social science. We would be delighted if the Nobel prize committee saw fit to honour us; who wouldn't be delighted to be so honoured? But our delight would be doubled if Mr Krugman was also included.

Jagdish Bhagwati
Columbia University
New York

Avinash Dixit
Princeton University
Princeton, New Jersey

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com SPECIAL
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

The Caucasus

A moment of truth

Nov 27th 2003 | MOSCOW AND TBILISI
From The Economist print edition

Reuters

After the bloodless coup in Georgia, the Caucasus may see real change. But only if the region's leaders and the superpowers who can influence them will seize it

Get article background

LIKE a giant discarded handkerchief, the white flag with its red crosses, the standard of ancient Georgia, still hangs messily over the presidential offices in Tbilisi. Inside, says Shalva Pichkhadze, the head of international relations, there is confusion; nobody has any instructions. Edward Shevardnadze drops by to pick up his things and jokes with reporters. For a man who has just been deposed as president, he seems in remarkably good spirits. The streets below buzz in anticipation of a future wide open with possibilities. Taxi drivers thrill at the memory of their “rose revolution”. Emboldened, students at the university are demonstrating to demand the sacking of their rector.

It has been an astonishingly swift transition. Just two weeks ago, most pundits in the capital were confident that Mr Shevardnadze, the “grey fox”, who kept his job as president of Georgia through civil wars, assassination attempts, and innumerable economic and political crises, would survive yet again. The opposition forces, noisy but disunited, would run out of steam; the people would resign themselves to the rigged parliamentary elections of November 2nd, as they had done many times before; and Mr Shevardnadze would hold on until the presidential election due in 2005, when he would appoint, or at least cut a deal with, his successor.

Instead, the opposition groups banded together. They staged repeated demonstrations, but carefully kept them peaceful, giving Mr Shevardnadze no excuse to unleash his security forces. Slowly, his supporters' nerve began to break. On November 21st, Tedo Japaridze, his national security adviser, publicly criticised the elections. The next day opposition protesters barged into parliament and forced Mr Shevardnadze to leave. He declared a state of emergency, but it fast became clear that much of the army and police would not back him. On November 23rd, he agreed to meet opposition leaders. They went expecting him to annul the elections. To their astonishment, he announced his resignation, asked to be allowed to remain in Georgia, and offered to help them in any

way he could.

Proud Georgians see this as proof that their country is fundamentally different to its “less civilised” Caucasian neighbours, Armenia and Azerbaijan. Both these countries also held flawed elections earlier this year. What followed was, in Azerbaijan's case, violently repressed riots and, in Armenia's, a weary acceptance by the people that they could do little to change things.

Georgia was different for many reasons. Mr Shevardnadze was already extremely weak and unpopular; even his old allies in the West had recently cooled towards him. The opposition itself was fresher, bigger and more driven than in the other two countries. Its most popular leader, who will almost certainly become president of Georgia after elections on January 4th, is Mikhail Saakashvili, a 35-year-old American-trained lawyer, who has also served briefly as justice minister. Armenia's main opposition candidate for the presidency this year was Stepan Demirchian, the son of an assassinated speaker of the parliament, who inherited his father's name and charm but not, alas, his capability. In Azerbaijan, the opposition is a rabble of tired leftovers from a short-lived former coalition government.

Another factor was that Georgia still has some free media. When Mr Shevardnadze tried to close down Rustavi-2, the main independent television station, two years ago, demonstrators crowded around the building to protect it. This meant that Rustavi-2 was able to go on broadcasting an alternative message, including—crucially—the results of the exit polls and independent vote counts showing that the official election results were fake. Also crucial was the foreign aid that paid for those polls. Western governments, in particular the United States, had kept close contacts with politicians like Mr Saakashvili. And foreign criticism of the fraud was much louder than it had been for Azerbaijan the month before, even though the Azerbaijani election was much more rigged.

But what happens next in Georgia will have consequences for those neighbours too. Though it has few direct links to them, all three can be proxy battlegrounds for influence between the two big countries that have interests in the region, Russia and the United States. A tussle over one could spark a tit-for-tat dispute in another. Ex-Soviet politicians such as Mr Shevardnadze, for all their weaknesses, are adept at the power games and bargains that keep competing interests—both domestic and foreign—in balance.

And he is the second such leader to depart this year. Heidar Aliev, who ruled Azerbaijan for the best part of three decades, has not been seen since leaving the country for medical treatment in the summer. His son, Ilham, who officially took over after last month's election, is a western-minded, well-educated polyglot like Mr Saakashvili, but with even less political experience. With the two flawed but dependable leaders replaced by fresh but untested ones, the Caucasus is once again an open field for the great powers to jostle for influence.

The politics of pipelines

What interests Russia and America most in the Caucasus are oil and gas, which the region has, and terrorism, which they fear it might breed. Start with the energy. America depends heavily on Middle Eastern oil; western Europe, on gas piped out of Russia (much of which comes from Central Asia). Both would like to depend less on those sources. Their hope lies in the oil and gas fields in the Caspian Sea. The elder Mr Aliev encouraged foreign oil firms to explore them; his son will preside over the epoch in which exploration becomes exploitation. Over the next 20 years Azerbaijan is expected to make $29 billion in oil revenues alone.

The pipelines that will carry this oil and gas westwards, across Azerbaijan and Georgia to Turkey, are now being built. But Russia already has its own pipelines to Turkey and the Black Sea. Thanks to the competition, Russia stands to lose not only transit fees, but also crucial levers of influence over the West. The state gas monopoly, Gazprom, signed a framework deal with Georgia this year whose terms are vague, but which seems to give Gazprom the right to expand Georgia's gas network. Some think this means that it will try to use Georgia as an export route for its own gas to Turkey, getting there before the trans-Caucasian pipeline is built.

Moreover, Russia supplies almost all of Georgia's gas. But in future

AFP

Georgia will be able to get much of it from the trans-Caucasian pipeline at an extra-cheap rate. In the past, Russia has cut off gas supplies in winter: theoretically for non-payment, but often apparently for political ends. Most notably, Russia has put the heat (or rather the cold) on Mr Shevardnadze when rebels from Russia's war-torn republic of Chechnya have used Georgia's Pankisi Gorge, across the border from Russia, as a hiding place. Russia's state electric company, UES, has also bought the main Georgian distributor, Telasi.

Saakashvili's her man

It clearly suits Russia to have a pliant government in Georgia. Mr Shevardnadze was despised by many in the Moscow old guard for his role, as Mikhail Gorbachev's foreign minister, in dismantling the Soviet Union. His strong ties to the West, and the American military aid that he accepted to fortify Georgia's ramshackle armed forces and fight terrorism, infuriated Russia. But his weakness also made him easy to manipulate. The question is whether Russia will continue to use the levers that it has in the past.

The main lever, besides gas, is Georgia's terrifying potential to fall apart altogether. It is not so much a country as a loose association of fiefs. Abkhazia and South Ossetia, which border Russia, have shown strong signs of wanting to merge with it. Russia, though it would never dream of actually taking them in, has stirred things up, for instance by granting Russian citizenship en masse to their inhabitants and maintaining army bases there. Ajaria, an autonomous republic on the Black Sea, is an exotic oddity: a seaside resort of legendary tidiness where local television broadcasts the news in several European languages. While it does not want to secede—it is, unlike the others, ethnically Georgian, though predominantly Muslim rather than Orthodox Christian—its leader, Aslan Abashidze, is used to having his own way. There are also other ethnically distinct regions, including Armenian and Azerbaijani enclaves. All view the Tbilisi government with varying degrees of scorn.

Mr Shevardnadze held a feeble grip on these regions at the best of times, and with his exit the centrifugal forces seem to have increased. The autonomous republics' leaders have all been in Moscow, seeking support and shrilly warning the Russians of Georgia's Balkanisation. Mr Abashidze has declared a state of emergency in Ajaria and closed the borders, while Ajarian television has been showing a film comparing Mr Saakashvili to Hitler. Other regional governors and several ministers have resigned, creating chaos.

Georgia's new leaders will have to deal with this fragmentation, as well as the virtually defunct economy and rampant corruption that Mr Shevardnadze encouraged, while maintaining their fragile coalition. For now they are doing well. The three main opposition parties have named Mr Saakashvili their common presidential candidate. He, despite a reputation for volatility and populism, has so far been measured and statesmanlike, with soothing words for Russia and even for Mr Abashidze. The two other leaders, Nino Burjanadze and Zurab Zhvania, will probably become speaker of parliament and prime minister respectively. But the coalition could break down. Mr Saakashvili has had rows with Mr Zhvania in the past, and looks like a man who quickly gets bored.

Russia, arch-meddler

Above all, much will depend on whether Russia wants to be a help or a hindrance. Its foreign minister, Igor Ivanov, helped mediate the talks between Mr Shevardnadze and the opposition, which some took as a sign of a new, more positive attitude. President Vladimir Putin welcomed the peaceful end to Georgia's crisis. But two days later Russia's line seemed to harden again, after a Russian-brokered peace deal for the conflict in Moldova collapsed. The deal would allow Russian troops to stay in Moldova until 2020 as “peacekeepers”, to oversee a truce between the Romanian-speaking majority and the Russian-speaking population of the Transdniestria region. Opposition parties, scared of Russian imperialism and heartened by Georgia's example, had staged rallies and promised bigger ones. The Moldovan president, Vladimir Voronin, pulled out of the deal at the last minute, citing a lack of support from western Europe. Mr Ivanov blamed western interference for both that and Mr Shevardnadze's ousting.

Such games have traditionally been played over any region where tension exists. Take Nagorno-Karabakh, the mountainous enclave in Azerbaijan populated mostly by Armenians. Azerbaijan wants to give the province some autonomy; Armenia claims it as its own territory. That Armenia maintains this

stand in the teeth of a larger enemy, international recognition that Karabakh belongs to Azerbaijan, and a crippling economic blockade imposed by both Azerbaijan and Turkey, used to be thanks mainly to Russia, with which it has a pact guaranteeing military support.

Nowadays, Russia's relations with Baku are as good as with Yerevan. But Armenia persists in its claim. Outright war has been avoided for the past decade thanks largely to Heidar Aliev, the former Azerbaijani president. Mr Aliev missed early chances to reach a peace deal, and he did little to prepare Azerbaijani society, of which one person in ten is a refugee from the fighting, for an accord that would mean giving up hope of returning. But he was skilled at the domestic and geopolitical game of keeping his country's scheming clans and outside forces in balance.

Ilham Aliev does not have his father's experience. So far, he has not even appointed or fired anyone. And while his own opinions are as yet unclear, many around him are clearly belligerent: Safar Abiev, the defence minister, said last week that the threat of a war would increase unless Armenian forces left Karabakh. Many in Azerbaijan believe that the coming oil bonanza will allow the country to build up its army and take on Armenia and Russia—a rash belief, probably, but it carries a risk of escalation.

Two paths ahead

The departure of its two old fixtures, Messrs Shevardnadze and Aliev, leaves the Caucasus at a crossroads where both triumph and disaster are possible. Which is more likely?

On the optimistic view, Russia's role in helping Georgia's peaceful revolution is a sign of hope—“the first positive diplomatic initiative in the 12 years since the collapse of communism, and a sign of Russia's maturing attitude,” says Paul Joyal, a Washington businessman and former adviser to the Georgian parliament's security and defence committee. With Mr Shevardnadze gone, Russia's old hostility towards Georgia melts away, at least partly. In return for concessions, such as a compromise on Russian-claimed property in Abkhazia or oil and gas deposits off its coast, Russia reduces its meddling in the separatist republics, encouraging their leaders to work more closely with Mr Saakashvili. He, in turn, manages to keep a governing coalition together and gets to work on Georgia's shattered economy and society. The country's strengthening democracy keeps the government in line, and renewed foreign aid pushes it forward.

AP

Russians keep out

Meanwhile, in Azerbaijan—the optimists go on—Ilham Aliev turns out to be something of a reformer, as many foreign officials and businesspeople in Baku think, and not the layabout his critics describe. He retires some of his father's cronies and promotes the younger generation already in government. They fight corruption and take charge of the economy, ensuring that the growing oil revenues—disbursed to the treasury by the one reasonably transparent institution in Azerbaijan, the state oil fund—go into reviving the stagnant non-oil economy. With prodding from the West, they carry out reforms to make elections cleaner. They also avoid confrontation with Armenia. Eventually, the combination of Russian and American encouragement persuade both countries to reach a settlement on Karabakh.

The pessimists see Russia's temperamental change of tone after the failure of the Moldovan peace deal as a sign that East-West relations are getting bumpy again. Another sign is the furore over the arrest of

Mikhail Khodorkovsky, a Russian oil baron, last month. As Washington-based critics of Mr Putin—from Mr Khodorkovsky's friends, to religious groups who dislike the Russian Orthodox Church's heavy-handed treatment of Christian minorities, to human-rights activists concerned about Chechnya—find common ground, America may turn less tolerant of Russia's misbehaviour. “We may see a restart of rivalries in former Soviet space,” says Dmitri Trenin, of the Carnegie Endowment's Moscow centre.

A suspicious Russia will not help, or may even undermine, the pro-western Mr Saakashvili, through the separatist leaders, pro-Russian businessmen and allies of Mr Shevardnadze. The new Georgian coalition will split or get bogged down in disputes. The country will stagger along as it did under Mr Shevardnadze, or worse.

Likewise, Russia may interpret any change in Mr Aliev's attitude—even if it is merely due to his own lack of judgment—as the result of American attempts to win more influence. One issue that could become sensitive is Azerbaijan's acceptance of American aid to fight terrorism, which Congress permitted this year for the first time. The Moscow hawks can use their connections to Heidar Aliev's ex-communist cronies to undermine his son, derailing reforms. Or he may turn out to be an ineffectual puppet anyway; egged on by those around him, he could slip into a new confrontation with Armenia.

The happy outcome seems unlikely in a region that has long known only strife and poverty, but it is not impossible. Much depends on the good sense and determination of the region's leaders, and on the will of its two main hegemons to work with each other. To suppose that a better future may triumph over the past may be daydreaming; but if it can ever happen, now is the best chance so far.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Medicare reform

The biggest turkey of all?

Nov 27th 2003 | WASHINGTON, DC
From The Economist print edition

AP

This week's law-making may have helped George Bush win next year's election—providing voters don't do the sums

ACCORDING to Otto von Bismarck, the making of laws, like the making of sausages, should never be watched. Congress this week illustrated his point. The Republican leaders were very keen to pass two laws that would help the White House—the energy bill and a huge extension of the Medicare programme—before adjourning for Thanksgiving. To do so, they subjected the world's most powerful democratic body to a messy mixture of arm-twisting, procedural manipulation and special-interest politicking.

Despite these sterling efforts, the Republicans actually failed on energy. Some 40 senators, including six Republicans, stood firm against the proposed law, enough to delay it by filibuster if necessary. A costly law that does little for America's energy problems, but piles subsidies and tax breaks in the lap of every conceivable business connected to energy, has been shelved—at least until January.

The mammoth Medicare bill, however, squeaked through. It passed the House of Representatives at 5.53am on Saturday, November 22nd, after an unprecedented three hours of voting. Normally, congressmen have 15 minutes or so to cast their votes. This time, the House Republican leaders held the roll-call open for three hours while they bullied the fainthearted. George Bush, just back from Britain, stayed up unusually late on Friday to lobby congressmen, and was woken before dawn on Saturday morning to plead with a few more. Disillusioned Democrats accused the Republicans of “stealing” the vote, just as they were supposed to have stolen the 2000 election.

The vote in the Senate was less dramatic. The Democrats' attempt at another filibuster was fended off, and the Medicare bill passed by 54 votes to 44 on November 25th, to the White House's jubilation.

More than any other piece of Mr Bush's domestic agenda, the expansion of Medicare to include prescription drugs is seen as the key to electoral victory next year. This is the biggest expansion of the government's health-care plan for the elderly since it was introduced in 1965, and the elderly may account for one in four of the votes cast in the election. By bundling a big new benefit into Medicare, Mr Bush has shown that he gets things done in Washington (unlike those useless Democrats, who talked about drug coverage for years but failed to deliver).

Health care is a leading issue for many voters; it ranks higher than tax cuts, for instance. In the

Democratic primary debates the contenders queue up to bash Mr Bush's bill. Not only has health care been seen as Democratic turf, but also older Americans especially have distrusted the Republicans on Medicare, believing they meant to undermine the entitlement. After all, didn't Newt Gingrich once hope in the 1990s that Medicare's bureaucracy would “wither on the vine”?

Now Mr Bush has put those fears to rest, and underlined the compassion in his conservatism. The White House hopes the Medicare drug benefit will be as defining for Mr Bush's domestic agenda as Bill Clinton's adoption of welfare reform (long a conservative issue) was for his presidency.

The political logic in all this is hard to fault. But turkeys, no less than slimmer poultry, eventually come home to roost. The full economic disaster of this one will probably not be apparent until after next year's election, since most of it will not come into effect until 2006. But people may begin to do the numbers before then. Whenever they do, it could be painful. For this hotchpotch of compromises provides neither a sensible drug benefit nor any real reform of the Medicare programme.

From the old folks' perspective, the bill does not mean (as many believe) that Uncle Sam will now pick up the tab for all their prescriptions. The $400 billion that the bill promises is only a fraction of the amount that America's old will spend on drugs over the next decade. Besides, not all that money will go towards pill-buying. More than $100 billion will go on subsidies to employers, doctors and private providers of health plans.

Retired people will have to pay a premium of around $35 a month. The coverage will kick in only after grandma has spent $250, and even then there will be a 25% co-payment, up to a total drug cost of $2,250. Between $2,250 and $3,600 there is no coverage. Only after grandma's bills top $3,600 does the government step in again. This “doughnut” benefit (with a large hole in the middle) could well be enormously unpopular. Although poorer old people (whose premiums will be subsidised) and those with exorbitant drug bills will be better off, not everyone will.

In fact, some old people may be worse off, especially if their former employers use this Medicare expansion as an excuse to stop providing them with drug coverage. The Medicare bill envisages spending over $80 billion to bribe these firms not to do that. But the Congressional Budget Office (CBO) reckons that 2.7m retired people may lose their employer-provided drug coverage despite the subsidies. As Steve Moore of the Club for Growth, a conservative anti-tax group that opposes the bill, puts it, the Medicare issue could become a “hand grenade that explodes in the Republicans' lap”.

History suggests that the wrath of the elderly is not something to be taken lightly. In 1988, Ronald Reagan also signed a bill that dramatically expanded Medicare to include catastrophic-health coverage and some prescription-drug benefits. That bill, too, was praised as the central plank of Mr Reagan's social policy and, like Mr Bush's bill, it got the coveted support of the huge old people's lobby, the AARP (the now official abbreviation of the American Association of Retired Persons). But the act was repealed in 1989 after protests from retired people, who resented the means-tested “surtax” they were asked to pay.

This year's Medicare bill carefully avoids some of the political mis-steps of 1988. As Norman Ornstein of the American Enterprise Institute points out, the Reagan benefit was entirely financed by premiums on retired people, it was means-tested, and the surtax kicked in long before the benefits. This time the plan is voluntary, the cash comes from the government, there is only a tiny means-tested component, and the carrots are available long before any sticks.

The early polls on Medicare provide no great comfort to either side. One survey of its members by the AARP found that 75% thought the law should be passed, even though 62% knew little or nothing about its details. On the other side, a poll by the AFL-CIO union federation, which has opposed the bill, found that 65% of its respondents disliked it too. A poll of retired people commissioned by Mr Moore's Club for Growth showed 43% of them supporting the bill, but that figure halving once they were told that it might raise costs for some. The best guide may be a poll by the independent Annenberg Public Policy Centre: it found the total population evenly split, but among the elderly only 33% supported the Medicare bill and 49% were against.

Written in red ink

This may explain why the Republicans have ensured that most of the law does not really take effect until 2006. Voters may decide to “wait and see”, and ignore Democratic scaremongering. But over the medium run—say, two years into a second Bush presidency—the drawbacks could become clearer.

By then the argument will be less about the added benefits than about fiscal recklessness. The $400 billion figure applies merely to the next decade. As the baby-boom generation starts to retire, the costs will balloon; the 20-year figure could reach $2 trillion, according to the CBO. Reformers had hoped that the generous new benefit would come with some effort to discipline a wasteful programme. Instead there is only limited means-testing, and only a few pilot schemes to test competition from the private sector starting in 2010.

You could argue that, after presiding over double-digit increases in non-defence discretionary spending, Mr Bush already sounded pretty hollow talking about budget discipline. Post-Medicare “reform”, his rhetoric is a sham. When Americans see the consequences of the red ink and start to care again about the budget, the Republicans could pay a high political price.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The economy

Up and away

Nov 27th 2003 | WASHINGTON, DC
From The Economist print edition

The good economic news keeps on getting better

GEORGE BUSH must be pinching himself this week. Not only did it bring the Medicare victory, but also a slew of extraordinarily rosy economic news.

Top of the list was a big upward revision to the already scintillating third-quarter GDP figures. According to the Commerce Department, America's economy grew at 8.2% on an annualised basis between July and September. Not only is that rate a full percentage point faster than the rate government's statisticians initially calculated, it is a growth rate more often seen in Asian tiger economies than rich countries.

The main reasons for the additional perk were upward revisions in the figures to do with inventories and investment. America's firms, it turned out, were slashing their stocks less aggressively and, more important, investing more strongly than the statisticians initially thought. Investment in equipment and software, in particular, saw a remarkable 18.4% rise. The strength of investment spending is the best indicator that America's recovery will prove sustainable even as the boost from all those tax cuts fades.

Hopes that investment spending would stay strong were strengthened by new evidence about corporate profits. The GDP report also showed that they rose almost 12% in the third quarter, and more than 30% compared with a year earlier—the biggest jump in almost two decades.

Although the economy will surely slow down from this sizzling pace during the last three months of the year, there were encouraging signs of strength this week. The Federal Reserve's latest “Beige Book” survey of economic conditions was notably upbeat, describing economic improvements as “broadly based”. Orders for durable goods soared by 3.3% in October, much higher than analysts had expected, suggesting that the recovery in American industry is speeding up. The Chicago Purchasing Managers Index, a barometer of conditions in the mid-west manufacturing sector, jumped to an eight-year high.

Consumers, too, are feeling perky. According to the Conference Board, consumer confidence rose in November to its highest level in more than a year. Americans were noticeably more bullish about the labour market, with a drop in the number of people claiming jobs were hard to find. Corroborating that evidence, the number of people filing for unemployment benefits this week fell by more than expected to 351,000—a 34-week low. The jobs market is hardly on fire, but it is looking in much better shape than a few months ago. All in all, a feast of good news for the president to savour at Thanksgiving—and a nasty dose of indigestion for Mr Bush's Democratic challengers.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The sniper trials

Hard Virginia

Nov 27th 2003 | VIRGINIA BEACH, VIRGINIA
From The Economist print edition

One to die, probably; the other still hopes it will just be jail

EPA

The condemned sniper

AT THE start of his trial for last autumn's sniper shootings around Washington, DC, John Allen Muhammad dismissed his lawyers, apparently thinking he stood a better chance of escaping execution if he conducted his own defence. He subsequently changed his mind, but it was too late. The jury that had convicted the 42-year-old former soldier of the fatal shooting of a man at a petrol station in Prince William County, Virginia, this week recommended that he be put to death. The killing of Dean Meyers was one of ten, says the prosecution, committed by Mr Muhammad and his then 17-year-old companion, Lee Boyd Malvo, during a three-week rampage that horrified Maryland, Virginia and the country's capital.

Although the 12 jurors were at first divided on whether to recommend the death penalty or jail for life without parole, some of them seem to have been influenced by Mr Muhammad's calculating manner during his six-week trial. “You could see the wheels turning in his head,” said Dennis Bowman, who was at first in favour of imprisonment. At one point Mr Muhammad remarked to a witness—one of the targets, who had been shot five times and left for dead—that he too knew what it was like to have his life on the line.

The matter now moves on to the trial of Mr Malvo in Chesapeake, not far from Virginia Beach. The youngster is said to have admitted actually to pulling the trigger in all the shootings. But this has not helped Mr Muhammad. The older man is accused of having customised the car from which the shots were fired so that the concealed rifleman could aim through a hole in the back. He was the “captain of a killing team”, as the prosecution put it.

There nevertheless remains some unease about his death sentence. Part of this arises from the fact that the federal attorney-general, John Ashcroft, decided that the two men should stand trial in Virginia, even though twice as many of the fatal shootings took place in Maryland. He is assumed to have done this because Virginia has a much fiercer record than Maryland in sentencing people to death. Only 17% of Virginian death sentences have been reversed on appeal, compared with a nationwide figure of 68%. As Steven Benjamin, the president-elect of the Virginia Association of Criminal Defence Lawyers, told the *Washington Post*, “If you are sentenced to death in Virginia, you will die.”

There is also the fact that Virginia's law about multiple murders, one of the grounds on which Mr Muhammad was brought to trial, seems to say that only the actual killer can be sentenced to death. Mr Muhammad was also charged under a new, more general anti-terrorism law, which does not have that qualification; but the new law has yet to be tested in the state's appeals courts.

Mr Malvo, too, is at risk of death; the state's law allows the execution of people for crimes they commit as minors. So his lawyers are saying he was brainwashed by Mr Muhammad, whom he described as his “father”. Hoping to show Mr Malvo as a young man gone astray, they called on his real father, who in tearful testimony recalled his son's appetite for ice cream.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Imported car factories

Buying jobs can be expensive

Nov 27th 2003 | VANCE, ALABAMA
From The Economist print edition

The South still woos foreign carmakers, but it isn't always worth it

MERCEDES-BENZ'S factory in Vance, Alabama, is large and cheerful, with bright yellow chairs in the cafeteria. Its workers have other reasons to smile. DaimlerChrysler, Mercedes-Benz's parent company, recently announced a $600m expansion which could double the number of jobs in Vance to 4,000 by early 2005. So many lorries are expected to roll into the expanded factory—upwards of 1,000 a day—that the workers will need pedestrian tunnels, and nearby Interstate 20 is growing from four lanes to six.

Since 1993 Alabama has acquired three large car factories—the Mercedes-Benz one, a Honda factory in Lincoln, and a Hyundai arrival that is scheduled to open outside Montgomery in March 2005. There is also a Toyota engine factory in Huntsville.

All this has brought sorely needed jobs. Some 26,000 workers have applied for the 2,000 positions the Mercedes-Benz expansion will create. Hyundai has begun hiring 1,600 workers. There are also new jobs in the smaller companies which have sprung up to serve the carmakers' need for “just-in-time” parts. Steve Sewell, of the Economic Development Partnership of Alabama, says this helps to make up for the thousands of manufacturing jobs the state has otherwise been losing. (Alabama's love-affair with Mercedes-Benz is not just statistical: Mr Sewell married Linda Paulmeno Sewell, the factory's communications director, two years ago.)

Engines of growth

Employment in the motor industry*

State	Main manufacturers	Numbers employed	Year
Alabama	Honda, Hyundai, DaimlerChrysler (Mercedes-Benz)	83,710	2002
Georgia	Ford, General Motors	64,400	2002
Kentucky	Ford, General Motors, Toyota	87,659	2003
Mississippi	Nissan	30,000	†
S Carolina	BMW	42,000	2001
Tennessee	General Motors (Saturn), Nissan	62,273	2001

Source: State statistics *Includes parts suppliers †Projected

But it comes at a price. In 1993, to beat off competition from North and South Carolina for the Mercedes factory, Alabama promised to spend $253m on tax incentives, on preparing the site and on training workers. That was nearly double the $130m South Carolina had promised to invest in a BMW plant which opened in 1995, and hugely more than Tennessee offered Nissan in 1980. A subsidy to make cars that Alabamians themselves could not afford, snorted the critics back then. Ten years on, Alabama now has 84,000 car-related jobs—a good deal, says Mr Sewell.

But this may not be true for all the states that would like to import car factories, especially as the necessary incentive grows larger and larger. Mississippi offered a $290m package for a new Nissan factory in Canton, which rolled out its first car in May; Nissan claims the plant will eventually employ 5,300 people. Georgia offered DaimlerChrysler $320m to build a new factory in Pooler, outside Savannah; the state had already bought a 1,500-acre site and set up a training programme when the firm pulled out of the deal in September.

Georgia's experience highlights the danger for southern states of expecting too much from the car industry. The South has some undoubted attractions for manufacturers—not least the relative feebleness of its trade unions—but it needs to spend a lot more on infrastructure, especially roads, if it is to be truly competitive. With factories relying more and more on getting just-in-time parts, something has to be done about the constant traffic snarls around Atlanta and Birmingham and the lousy roads of western Alabama. Of the $290m package that Mississippi offered Nissan, says Sherry Vance of Advantage Mississippi, a government agency, $210m went to infrastructure improvement. And the quality of local labour is not all it should be. Nissan has gone recruiting in 78 of Mississippi's 82 counties, but still needs more good people.

Large investments may not bring all that much benefit, Alabama's success notwithstanding. Kelly

Edmiston, an economist at Georgia State University, surveyed job growth in Georgia's bigger firms between 1984 and 1998 and concluded that the expansion of existing firms produced more new jobs than the introduction of new firms. He believes that states might be better off helping local businesses to grow.

Certainly, state governors cannot assume they will keep their own jobs by importing car factories. Roy Barnes was unable to hang on as governor of Georgia despite announcing the Pooler expansion a week before the November 2002 election. Ronnie Musgrove, who as governor of Mississippi oversaw the wooing and winning of the Canton plant, lost his job earlier this month. No Alabama governor has won re-election since the Mercedes-Benz deal was signed. Money won't necessarily buy political longevity.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Drugs and the heartland

You take the high road

Nov 27th 2003 | CHICAGO
From The Economist print edition

A new Moonshine is brewing—and threatening rural children

AP

Not child's play

BEHIND the big red barns, in farmers' fields and in the forests of middle America, an evil brew is cooking: methamphetamine. The powerful stimulant, more commonly known as speed, has been a growing menace in the countryside for six years or more. Now attention is turning to the lives of children who suffer from the drug—from the noxious fumes its manufacturers produce, from the risk of fire and explosions, and from abuse or neglect by adults on a long, cheap high.

Bill Clinton's drug tsar, Barry McCaffrey, called speed (or, depending on your fancy, meth, crank, ice, tweek or chicken feed) “the worst drug ever to hit America”. A recent Justice Department report says it is the country's fastest-growing drug threat and its most common synthetic drug. Nearly one in 20 Americans are thought to have used it at some time in their lives. No fewer than 15,353 meth labs were uncovered last year, up from 8,971 in 2000.

Children are in the front-line. Last year 2,023 of them were found living on the site of seized meth labs, and 1,373 were exposed to toxic chemicals. For every 1lb of speed produced, a manufacturer will leave behind around 6lb of toxic waste. When police raid the sites they wear chemical suits and gas masks. Between 2000 and 2002, 52 children were injured and five killed in meth-related incidents.

The problem is particularly bad in the rural mid-west. Iowa has fought a long war against the drug. Dale Woolery, associate director of Iowa's drug control office, draws attention to the toll on children. It was discovered in the latest fiscal year that 720 child-abuse cases in the state were connected to speed labs. Iowa's foster-care system is overwhelmed. Rizwan Shah, a doctor at Blank Children's Hospital in Des Moines, tells of a two-month-old brought in with severe breathing problems after exposure to meth fumes, and a 14-year-old girl who chewed a coffee filter used for a meth filtration and died.

Last month the Bush administration's drug officials came to Des Moines to unveil a new $2.5m initiative to help “speed children”. Missouri, Oklahoma, Tennessee, Illinois, Indiana and Minnesota are also pouring money into the problem. But it is hard to fight, particularly in rural states.

The attraction of speed is simple: both customers and producers get more bang for their buck. Customers get an intense “rush”—euphoria, increased libido—for less money than what heroin, cocaine or even marijuana would cost. From the manufacturer's viewpoint, the ingredients for speed are cheap and plentiful, and you don't have to wait for anything to grow.

Ever since the 1980s, drug “superlabs” in the west, south-west and now Mexico have churned out the stuff. The labs in the mid-west are smaller, home-run affairs. A struggling farmer can get the recipe from the internet. One common ingredient is anhydrous ammonia, a crop fertiliser that is highly toxic when released in clouds from pressurised tanks; another, pseudoephedrine, is found in medicine for colds. Lithium batteries, drain cleaner and engine-starter fluid have also been used. A small laboratory, and its nasty smell, are easy to hide in a pungent farmyard.

Every spring, says Dr Shah, Iowan farmers out tilling their fields uncover the remains of meth labs. Creek beds, national forests and other places where children like to play are also being contaminated. Even with the new money, and some recognition of the scale of the problem, the heartland will still be a

dangerous place for many children to grow up in.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Lexington

Cut from the same cloth

Nov 27th 2003
From The Economist print edition

A lesson in blue-blooded political management

THERE is no sorrier branch of literature than the books that presidential candidates write to boost their campaigns. Who now reads Michael Dukakis's "Creating the Future"? Or Bill Clinton's "Putting People First"? And who, in six months' time, will read John Kerry's "A Call to Service"? Or Dennis Kucinich's "A Prayer for America"? If literary standards count for anything, these sententious tomes should all be consigned to the flames.

Howard Dean's forthcoming campaign biography, "Winning Back America", is a slight exception. This is partly because Dr Dean is an unusually interesting candidate: a no-hoper who turned himself into a front-runner by tapping into a rich vein of anger in the body politic. But the book also tells us about Dr Dean's similarity to George Bush.

The most obvious likenesses are draft-dodging and drink. Both men avoided the Vietnam war: Dr Dean failed his army medical with a bad back, but then spent ten months skiing. Both were drinkers: Mr Bush woke up with such a hangover on his 40th birthday that he decided to give up alcohol forever. It turns out that the same is true of Dr Dean. "When I drank, I would drink a lot and do outrageous things, and then I wouldn't drink again for a while. I realised that what was very funny when you're 18 is not very funny when you're 30." He woke up with such a hangover after his bachelor party that he too decided just to stop drinking.

The deeper similarity has to do with social background. Both Howard Brush Dean III and George Walker Bush hail from the same White Anglo-Saxon Protestant (Wasp) establishment: a world of blue blood and old money, of private schools and deb balls, of family connections and inherited first names. Their fathers and grandfathers were educated at the same Ivy League university, Yale. One of Mr Bush's grandmothers was a bridesmaid for one of Dr Dean's (they had been at finishing school together). Dr Dean's father worked as a stockbroker at Dean Witter Reynolds, and the young Howard grew up on Hook Pond in East Hampton and on Park Avenue. He was educated at St George's in Newport, a posh boarding school, and then at Yale, where he overlapped for a year with Mr Bush, who had been to Andover.

So why do people with such similar backgrounds have such different political views? Fifty years ago America's Wasps saw eye-to-eye on politics just as much as they did on trust funds and Ivy League universities. Most of them were relatively relaxed Republicans: high-minded and fiscally responsible at

home, Atlanticist and Anglophile abroad. The Bushes and Deans were both rooted in this tradition. Mr Bush's grandfather, Prescott (who, incidentally, also went to St George's), was a senator for Connecticut who believed in progressive taxation, internationalism and birth control. Dr Dean's father, “Big Howard”, managed the campaigns of a Republican congressman, Stuyvesant Wainwright II. His mother wore a dress emblazoned with the word “Ike” during Eisenhower's re-election bid in 1956.

These moderate Republicans began to lose their grip on the party in the mid-1960s. Dr Dean's first political experience was at the 1964 Republican convention which chose the upstart Barry Goldwater as its candidate. Big Howard had a soft spot for the Arizonan, but the convention in San Francisco, where hundreds of decidedly unWaspish delegates from the South and the west booed Nelson Rockefeller off the stage, was a turning-point. Goldwater's subsequent obliteration by the Democrats gave the Wasps some comfort, but the debates that followed over the Vietnam war and civil rights polarised the country, pushing the Republican Party to the right. Every elected Republican president since then has come from the Sunbelt, and the religious right has pushed all sorts of issues into politics—from abortion to prayer in public schools—that the Wasps thought had no business there.

A handful of blue-bloods continue to uphold the great tradition of progressive Republicanism, Senator Lincoln Chafee of Rhode Island being the most conspicuous example. But most of them have had to jump either to the left or the right. George Bush senior was the first Wasp to throw in his lot with Sunbelt Republicanism. The current President Bush's ideology, especially on social issues, is by many measures to the right of Goldwater's. Until recently, Dr Dean might have been cited as a Rockefeller Republican himself, masquerading as a moderate Democratic governor of Vermont. But he has become a national figure only by jumping to the left, espousing campus liberalism, denouncing NAFTA and calling for a wholesale re-regulation of business.

An old order, remade

Have the Wasps been marginalised? The Preppies certainly no longer rule on their own terms. Look at the way Jim Jeffords sank into obscurity when the moderate Vermont senator abandoned Mr Bush's party to become an independent. For a Wasp to get anywhere in politics, he has to put on cowboy boots or Birkenstock sandals. On the other hand, Messrs Bush and Dean also demonstrate the extraordinary adaptability of America's old ruling elite. As David Brooks of the *New York Times* has pointed out, fancy boarding schools did quite well at turning “the sons of privilege” into “paragons of manly virtue”. Eton, which has not turned out a British prime minister for 40 years and may never do so again, should be jealous.

Indeed, the amazing thing about the survival of America's Wasps is why their prominence arouses so little comment. Britain would be on the point of revolution if its election could be caricatured as Eton v Harrow. The 2000 contest between Al Gore and Mr Bush was also a struggle between St Alban's and Andover. Next year, it looks like being Andover v St George's. There is nothing wrong with America's old elite. Whether there is anything wrong with America's commitment to upward mobility is a much more open question.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Latin America and the United States

Between rivalry and co-operation

Nov 27th 2003 | MEXICO CITY, MIAMI, SÃO PAULO AND WASHINGTON, DC
From The Economist print edition

EPA

A relationship in flux

"NEVER in America...has there been a matter requiring more good judgment or more vigilance, or demanding a clearer and more thorough examination." So said José Martí, Cuba's independence hero, of the first effort by the United States to unite the two halves of the Americas, at the Pan-American Congress in 1889. A century later, in Miami in 1994, Latin America's leaders (except Cuba's Fidel Castro) finally set aside their suspicions and endorsed George Bush senior's vision of a Free-Trade Area of the Americas (FTAA), from Alaska to Argentina, and of democratic co-operation with the United States.

Back in Miami last week, the region's trade ministers stumbled on towards that shimmering mirage, but hardly in step. To keep the FTAA show on the road, they stitched together a compromise. Out went the wide-ranging accord they have spent years negotiating. Instead, they will seek a "flexible", 34-country agreement, comprising only a few common standards and some tariff cuts.

That suits Brazil. Its leftish president, Luiz Inácio Lula da Silva, does not want to have to open up his country's service industries or government contracts to foreign competition—or at least not so long as the United States insists that its own farm subsidies and anti-dumping laws can only be discussed in the stalled global talks of the World Trade Organisation (WTO). Argentina, Paraguay and Uruguay, Brazil's partners in Mercosur, South America's putative customs union, backed Lula's position with varying degrees of enthusiasm.

But in Miami, half a dozen other Latin American countries, including Colombia and Peru, rushed to sign up for talks on what Robert Zoellick, the United States Trade Representative, called "state of the art" bilateral trade agreements—outside the FTAA. The United States already has such agreements with Mexico (in the form of the North American Free-Trade Agreement, NAFTA, signed in 1993) and Chile, and hopes to wrap one up with five Central American countries this year.

Formally speaking, the FTAA remains on schedule (it is supposed to come into effect in January 2005). Only a few weeks ago, Brazilian and American officials were bad-mouthing each other over the collapse of the WTO talks in Cancún. Neither wanted a repeat in Miami.

The messy compromise underlined the uneasy state of relations between the United States and Latin America. As a presidential candidate, with an eye on the Hispanic vote, George Bush junior promised to take the region seriously. In September 2001, he invited Mexico's Vicente Fox for a state visit,

proclaiming that America had “no more important relationship” than with its southern neighbour.

Days later, the terrorist attacks on New York and Washington imposed different priorities on Mr Bush. Latin Americans, having suffered “pre-emptive unilateralism” from the United States in the past, in the form of invasions and coups, were unsympathetic to the war in Iraq. The Bush administration, in turn, felt betrayed by Mexico (especially) and Chile, who as temporary members of the UN Security Council hewed to an anti-war line.

Latin Americans have other gripes about the giant to the north. Did not the United States champion the “Washington Consensus” of free-market economics which, rightly or wrongly, they blame for five years of stagnation in the region? The Bush administration is also accused of being unhelpful when Argentina's economy collapsed in 2001-02. At the same time, Mexico's ambitious hopes for an agreement regulating migration with the United States were dashed by an economic slowdown north of the border.

Partly because of these economic woes, democracy has been under strain in some South American countries. Others, such as Brazil, have recently elected left-wing governments, instinctively suspicious of “*Yanqui* imperialism”. North America's war on drugs stirs southern resentments. And none of this has been helped by a perception that nobody has been properly in charge of Latin American policy in the Bush administration. Hence, perhaps, America's apparent endorsement of a failed coup last year against Hugo Chávez, Venezuela's president.

One step forwards

In recent months, however, this picture has become more blurred. As the Bush administration chases Hispanic votes for next year's presidential election, it has begun to repair relations with Latin America. But with Lula in Brasília, relations between Brazil and the United States have become both more portentous and more complicated. “An adversarial relationship with Brazil would be extremely damaging to United States policy and interests in Latin America,” says Peter Hakim of Inter-American Dialogue, a Washington think-tank.

The White House's desire to improve relations was evident last year when it gave a bridging loan to Uruguay and backed IMF help for Brazil. It has since helped Argentina to get back on terms with the Fund. That void in Latin policymaking has been filled by Roger Noriega, a problem-solver (albeit one obsessed by Cuba), who has taken over the top Latin America job at the State Department.

The thaw continued this month at the annual joint meeting of the Mexican and American cabinets. Fernandez de Castro, an international-relations specialist at ITAM, a Mexico City university, says this produced “a sort of forgiveness” towards Mexico over Iraq. Meanwhile, several bills that would extend rights to some migrants are on the move in the American Congress.

Mexico has special reasons to want better relations with the United States. It has looked on with anxiety as Brazil's Lula has taken on a self-appointed role as champion of South America and of the developing world. New trade deals of the sort Lula is seeking will dilute Mexico's preferences under NAFTA. One sign of Mr Fox's nervousness is his firing of Mexico's ambassador to the UN for a few loose anti-American remarks. The ambassador, Adolfo Aguilar Zinser, had already riled Colin Powell, the American Secretary of State, during the Iraq debates. In a talk to students, he reportedly complained that the United States still sees Mexico as its “backyard”, rather than an ally on a par with some in Europe. Many Mexicans would agree, and in normal times Mr Aguilar might have survived. Not now.

Brazil's dilemma is different. In his first year as president, Lula has been a tireless traveller. His government wants a bigger role in the world, and a leading one in a united South America. Both aspirations could involve frictions with the United States. But so far, the two giants have tended to overlook differences rather than to resolve them. Lula was the first premier critical of the war to be invited to the White House. This might be because he is a conciliatory type, though the Americans also prefer his popular and democratic brand of left-wing politics to the region's populist and undemocratic sort.

Despite the Miami compromise, the FTAA remains an awkward issue for Brazil. The deal allows the country to continue to shield its economy as it pursues a government-inspired drive to become an economic heavyweight. But there could well be a price: less access to the American market, and perhaps less investment than other Latin American countries. And Miami showed that much of South America rejects Brazilian leadership. “On an issue that Latin America really cares about Brazil is seen as being not

forward enough," says Miguel Díaz, of the Centre for Strategic and International Studies in Washington.

More widely, Brazil's traditional instinct is to favour what Celso Amorim, the foreign minister, has called "benign restraint" on American hegemony. In practice, Brazil seeks to act as an honest broker in regional disputes while reserving the option to challenge the United States. Thus, Brazil offered to host talks between the government of Colombia, America's closest ally in the region, and the drug-financed rebels that fight it. This month José Dirceu, Lula's top political adviser, suggested that a militarily united South America could assist Colombia's government; otherwise, he worried, American aid to Colombia could turn into an "occupation" of the Amazon.

Brazil leads a "group of friends", to which the United States also belongs, seeking to mediate between Mr Chávez's government in Venezuela and the opposition. Yet Lula also courts Mr Chávez. Brazil and the United States "could well end up at odds over how to manage [Venezuela]," says Mr Hakim, the think-tanker.

In January, Brazil will begin a two-year stint on the UN Security Council (it has long wanted a permanent seat). That could see it voting against the United States on Iraq. If so, much care will be needed if the fragile Brazilian-American partnership is not to rupture. Should that happen, the Americas would begin to resemble two rival camps, grumbling at each other.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Canada

Now let's dig an expensive hole

Nov 27th 2003 | HALIFAX, NOVA SCOTIA
From The Economist print edition

A plan for an improbable tunnel finds backers

ABUTTING the open Atlantic and forming Canada's rocky eastern fringe, Newfoundland is a very long way from the country's main cities. But if Danny Williams, a millionaire businessman elected as the province's Conservative premier last month, gets his way, it will become a lot less remote—or at least its two constituent parts will be less remote from each other.

Mr Williams has revived an old plan to lay a 17km (11 mile) tunnel costing at least C$1.5 billion ($1.2 billion) under the Strait of Belle Isle, which separates the island of Newfoundland (population: 490,000) from Labrador (pop: 28,000), on the mainland. The tunnel would sit in a ditch cut from the shallow river bed. It would carry power and fuel lines; cars would cross on electric trains.

The promoters, headed by Tom Kierans, a 91-year-old mining engineer, argue that the tunnel would bring both economic and political benefits. They hope it would revive the province's economy by attracting tourism and industry. Despite offshore oil, and a big nickel mine at Voisey Bay, Newfoundland has lost a tenth of its population in 20 years. Politically, the tunnel would tie Labrador more closely to Newfoundland, to which Britain's Privy Council awarded it in 1927. Until then, it had been claimed by Quebec, with which it has growing road and rail links. The Quebec government has never wholly relinquished its claim.

Alas, the tunnel looks like a white elephant in the making. The site is 12 hours by road from St John's, Newfoundland's main town (of 180,000 people). A new road links Red Bay, on the mainland, to Cartwright, but neither place has links to anywhere very useful. Mr Kierans talks of 3,000 cars a day using the tunnel. That smacks of fantasy: the proposed bridge linking Sicily (pop: 5m) to Calabria (pop: 2m) is expected to carry fewer than 5,000 cars a day.

Newfoundland has a long history of expensive follies. The government sank C$18m into a failed scheme to grow cucumbers in hydroponic greenhouses. Mr Kierans was himself behind an attempt to bring hydro electricity from Labrador to the island by tunnel, abandoned in 1975 because of water leakage after

C$75m of public money was spent.

Enthusiasts argue that Canada was built on improbable engineering feats, such as the trans-continental railways across the vast emptiness of the prairies. Mr Kierans points to the success of the 12.9km Confederation Bridge linking Prince Edward Island (PEI) to the mainland, opened in 1997. Two-thirds of its C$1 billion cost was covered by bond sales, and tourists have flowed across. Mr Kierans hopes private money might pay for most of the tunnel. But PEI is much less remote than Newfoundland. In eastern Canada, geography is still destiny—and, cynics might say, boondoggles are a growth industry.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Colombia's paramilitaries

Forging and forgetting

Nov 27th 2003 | MEDELLÍN
From The Economist print edition

A dubious disarmament plan

AP

No more violence, I promise

IN THE mountains outside Medellín on November 24th, “Comandante R”, the head of the *Nutibara Bloc*—one of Colombia's right-wing paramilitary groups—sat pondering his last hours as a warrior. Next morning, the comandante (real name Giovanni Marin) led over 800 men down the mountain and out of the city's slums to lay down their guns. He promised that none would “return to take up arms”. His men then deposited their weapons and uniforms in front of Luis Carlos Restrepo, the government peace commissioner.

This showy ceremony was supposed to mark the start of an historic peace process, involving President Álvaro Uribe's government and the paramilitaries of the United Self-Defence Forces of Colombia (AUC). Formed in the 1980s by wealthy landowners and drug traffickers to combat the left-wing rebels of the FARC, the AUC isa fractious umbrella group dominated by regional strongmen. Both it and the government now say they hope the Medellín event will spark a wider demobilisation by the end of 2005.

But there are many obstacles. The biggest is what to do with AUC members who have committed heinous crimes. Mr Uribe proposes that killers and drug traffickers—the AUC is thought to derive 40% of its income from drugs—should be allowed to pay unspecified reparations to their victims, instead of going to jail. The government insists that there were no criminals among those who disarmed this week. They were sent to live under supervision in a Medellín suburb for a mere three weeks. They will get a government stipend of $6,300 a year.

Critics of this approach, such as Jorge Alberto Uribe (no relation), the new defence minister, argue that pardons before political negotiations have begun are inadvisable. It is feared that common criminals may have bribed their way into the AUC, to benefit from the mooted amnesty. Human Rights Watch, a lobby group, says the AUC's leaders should be arrested. The United States wants to extradite several.

Luis Guillermo Pardo, once Medellín's own peace commissioner, worries about security in the areas that the paramilitaries used to control. The mayor of Medellín dispatched 600 policemen to fill the void, but that might not be enough to maintain order. Mr Pardo also warily recalls what happened in 1994, when 650 other renegades were demobilised. Then, the militias were allowed to keep their arms and form private security forces, which resulted in at least 100 deaths.

Entering politics is now the ambition of Comandante R: he wants to go back to law school, and perhaps run for Congress. But, as it stands, the president's proposed amnesty law, which Congress might not get round to considering until next year, would prevent him from seeking political office. Pardoning killers, then limiting their chances to resolve their grievances peacefully, might be unwise.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Ecuador's government

A bad, bad trip in Quito

Nov 27th 2003 | QUITO
From The Economist print edition

Did the president take drug money?

Get article background

EACH of Ecuador's last two elected presidents was ejected after fewer than 18 months in power. Does Lucio Gutiérrez, who took office in January, now risk a similar fate? Already abandoned by his erstwhile allies on the left, Mr Gutiérrez, a former army colonel, now faces questions about his integrity.

El Comercio, Quito's leading newspaper, says that, in order to help pay for his election campaign last year, the president's aides took $30,000 from the family of César Fernández, the former governor of a coastal province. Mr Fernández was arrested in October, accused of exporting almost half a ton of cocaine to Mexico. The tourism minister, Hernán Plaza, resigned after admitting he had travelled on a plane later seized in the drugs raid. The president's sister and her husband, who is the head of his party, have admitted that they dined with Mr Fernández's Mexican friends.

Mr Gutiérrez has vehemently denied taking drug money, and has promised to resign if any proof emerges. He calls the whole affair a “conspiracy” to discredit him. The Congress has launched an investigation. But many Ecuadoreans have already made up their mind. Mr Gutiérrez's approval rating has dropped from 57% to 18% since the start of this year; in one poll this month, 85% said they didn't believe him.

In an attempt to relaunch his tarnished government, Mr Gutiérrez this week asked six ministers to resign. He may try to recruit replacements from the conservative Social Christians, the largest party in Congress. Mauricio Pozo, the orthodox finance minister, is likely to stay in his job.

Against the odds, Mr Gutiérrez has managed to balance the public finances and, with the support of the Social Christians, push through reforms to the customs administration and civil service. The government says it will bring in private firms to manage the state-owned electricity and telecoms companies. That has been enough to keep the IMF more or less happy, though it wants a tax reform.

Mr Gutiérrez may survive the scandal. Should he be forced to resign, Congress would appoint a successor— though the divided legislature might be unable to agree on who should get the job. In any event, the president has been weakened. Oil apart, the economy is stagnant, and unemployment has climbed to over 10%. In the circumstances, it would be surprising if Mr Gutiérrez completes his term in 2007.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Correction: Canada's defence policy

Nov 27th 2003
From The Economist print edition

In our story on Canada's defence policy ("On the cheap", November 15th), we mistakenly said that C$1 billion was equal to $1.3 billion. Despite the Canadian dollar's recent rise against the greenback, the correct figure was of course $770m. Apologies for this slip.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

China

Trouble on the fringes

Nov 27th 2003 | BEIJING AND TAIPEI
From The Economist print edition

Democrats in Hong Kong and Taiwan are defying the government in Beijing

LIFE would be so much easier for the Communists who rule China if it were not for those pesky democrats on its periphery. The grumpy (though, these days, not quite so old) men in Beijing have been waxing bellicose against Taiwan, whose parliament this week was voting on the sensitive principle of referendums. Presidential elections are due next March on the island, and China fears that the incumbent, Chen Shui-bian, may use his re-election bid, plus this tool, to push Taiwan closer to declaring its formal independence from the mainland. Hong Kong is also turning into a headache. Instead of showing gratitude for China's recent efforts to boost its economy, voters there have just hammered the main pro-China party in local council elections.

China has never been good at winning over voters in Taiwan or Hong Kong. In 1996 the Chinese went in for a bout of sabre-rattling against Taiwan, “testing” its missiles close to the island. This merely boosted support for candidates opposed to reunification with the mainland. As for Hong Kong, China so dislikes the Democratic Party that its leaders are not allowed to cross the border—even though Hong Kong is now part of China. Yet the Democrats have always been the biggest elected party in the legislature, and in elections on November 23rd widened their lead as the biggest party in the district councils as well, at the expense of the pro-government Democratic Alliance for the Betterment of Hong Kong (DAB).

Now China feels that the stakes are getting higher. It worries that if Mr Chen is re-elected next March, he will use his second four-year term to push his Democratic Progressive Party's (DPP) agenda for Taiwan's legal separation from the mainland. Taiwan calls itself independent already, but its constitution, based on that of 1947, suggests that it is still part of a China that includes the mainland. Mr Chen announced in September that he wanted a new constitution to be adopted by referendum in 2006. This would take effect in 2008, after the completion of his second term. The Chinese think Mr Chen's aim is to create an independent “Republic of Taiwan”, even though DPP officials say they have no plan to change the status quo.

China is deeply concerned about Mr Chen's insistence on a referendum. This could enable a new constitution to bypass Taiwan's legislature, where the main opposition party, the Nationalist Party or Kuomintang (KMT), has enough votes to block constitutional change. Having at first opposed the idea, the KMT this week realised its position was costing it votes, and as *The Economist* went to press on

November 27th parliament looked set to approve a bill which introduces a mechanism for referendums—despite Chinese warnings that this could lead to “disaster”.

The Chinese have reason to be concerned. In 2008 Beijing will host the Olympic Games, an event of enormous political importance to the leadership. Some DPP officials believe that the mainland's desire not to have the event overshadowed by a violent conflict with Taiwan and its chief military supplier, the United States, gives Taiwan greater room for manoeuvre in any push for legitimacy as a separate nation. The chances of Taiwan formally declaring independence, and of China going to war, are thought to be low, but the danger of miscalculation may be growing.

In China-Taiwan relations, America's attitude is crucial. Mr Chen recently stopped off in New York on his way to Panama, where he shook hands with Colin Powell. Therese Shaheen, who oversees the American Institute in Taiwan, America's surrogate embassy there, called George Bush the “secret guardian angel” behind Mr Chen's unusually high-profile trip. When China's prime minister, Wen Jiabao, visits America on December 7th, he is sure to complain that America is not doing enough to signal its displeasure with Mr Chen's “provocations”.

China's problems in Hong Kong are growing too. Given the high turnout, the unusually poor performance of the DAB in the elections suggest that Hong Kong voters wanted to show continuing dissatisfaction with Tung Chee-hwa, the territory's Beijing-appointed chief executive. In July, half a million people demonstrated against Mr Tung and his plans to introduce a new anti-subversion law—the biggest protest since Britain handed Hong Kong back to China in 1997. Since then, China has tried to boost Mr Tung's popularity by allowing him to withdraw the bill and by trying to boost Hong Kong's economy with measures such as increasing Hong Kong's access to its market.

These measures appear to have achieved little. If the DAB accepts the offer of its chairman, Tsang Yok-sing, to take responsibility for his party's losses by resigning, Mr Tung could find himself in further trouble. Mr Tsang is a member of Mr Tung's cabinet. If he resigns from that body too (he holds the position partly by virtue of being the DAB's chairman), Mr Tung could find it more difficult to control the legislature.

Even more worrying for Mr Tung and his Chinese masters must be the possibility that in legislative council elections next September pro-democracy politicians will enjoy similar gains. The number of directly elected seats in these polls is due to be increased from 24 to 30, half of the total. Pro-democracy politicians do far better in direct elections. This could lead to a more adversarial relationship between the executive and the hitherto overwhelmingly pro-government legislature.

Hong Kong's democrats are keenly aware of China's dilemma. China regards the territory as a model of the “one country, two systems” formula by which it hopes to tempt Taiwan back into the Chinese fold. The Democrats want Hong Kong's chief executive and legislative councillors all to be directly elected by 2008. By allowing this, they argue, China might persuade Taiwanese leaders not to stray too far towards formal independence. But the fear of the grumpy men in Beijing is that a more democratic Hong Kong will become more like Taiwan, run by leaders they do not trust.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

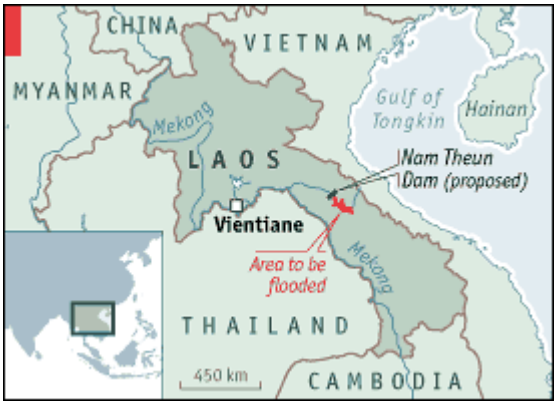
About sponsorship

Laos

Damned if you do

Nov 27th 2003 | NAKAI PLATEAU
From The Economist print edition

The World Bank ponders the Nam Theun dam



Get article background

FOR decades, the government of Laos has contemplated building a big dam on the Nam Theun river, a tributary of the Mekong. For the past ten years, it has been asking the World Bank to provide loan guarantees for the $1.2 billion scheme. Umpteen engineers, environmentalists and social workers have sniffed around the Nakai plateau, part of which will be flooded by the dam's reservoir. As the latest delegation passes through, one of the locals wheeled out to meet it complains that he has attended 14 such consultations in the past two years. When, he asks, will his grand visitors make a decision?

Now, at least, some of them have. This month, Thailand's electricity company signed a much-delayed deal to buy most of the power the dam will produce. The contract gave the consortium building the dam 18 months to secure financing. But commercial banks are wary of association with Laos's unreconstructed communist regime and with the flood of environmental and social protests that big dams inevitably induce. So they will not stump up any money without the World Bank's approval.

The bank's choice is not an easy one. On the one hand, the revenue from the dam would be a windfall for dirt-poor Laos. The government, which took in only $275m in revenue last year, would earn some $2 billion in the dam's first 25 years of operation, probably starting in 2009. What's more, the government and the developers have promised all manner of sweeteners. They will resettle the 5,700 people whose villages will be flooded in swanky new houses, and help them to set up farms and fisheries. The government has also pledged to protect the animals and trees of the Nam Theun's mountainous watershed.

On the other hand, the government has already allowed unfettered logging on the Nakai plateau, in contravention of an earlier promise to the World Bank. It also devotes more of its paltry income to defence than education or health. Yet diplomats say that it denounces any scheme to reserve all revenues from the dam for development programmes as an infringement of its sovereignty. Besides, as the World Commission on Dams noted in 2000, the benefits of big hydropower projects are usually overestimated, and the costs underestimated.

While the World Bank weighs its decision, the government of Laos has announced plans to build five lesser dams with help from Vietnam. Cynics say the Laotian authorities have learned that it is easier to do without World Bank funding, and all the environmental and social protections that come with it.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

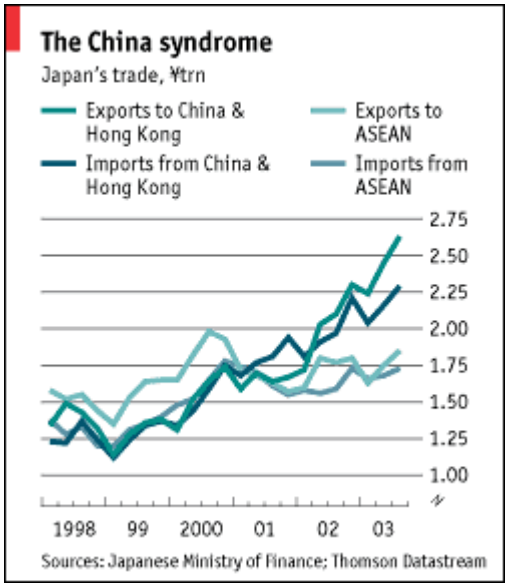
About sponsorship

Japan's economy

Learning to love a growing China

Nov 27th 2003 | TOKYO
From The Economist print edition

From threat to opportunity



NOT long ago, while Japan fretted about imports of *tatami* mats and *shiitake* mushrooms, American firms saw China as a land of opportunity. Lately, however, Japanese complaints about Chinese competition have grown more muted, whereas the United States tries to slow Chinese imports of everything from textiles to televisions. Some Japanese are even starting to worry about a different kind of threat—that China's rapid growth may slow.

China's advantages as a fast-growing neighbour are becoming more apparent to Japanese businessmen, who used to complain about its cheap imports. From January to October of this year, Japan's exports to China accounted for nearly two-thirds of its export growth. Besides selling basic consumer goods, Japanese firms have also been exporting to Japanese companies based in China. This has boosted exports of everything from basic inputs such as steel and chemicals to capital equipment.

This gives Japan a broader demand base than it had during its three short-lived rebounds over the past decade. Then, government spending and exports of cars and electronics to America seemed to be the only engines of demand. Now, Asia accounts for 48% of Japan's exports, and America 24%, while optimism and higher profits have also boosted domestic investment by Japanese firms a bit, at least temporarily. But Japan's recent cyclical upturn still looks too weak to withstand much bad news, and one of the biggest concerns in Tokyo these days is that warnings of an overheating Chinese economy will prove well-founded—and that as China begins to cool off, Japan's economy will once again freeze up.

Even so, most Japanese are hardly ready to embrace the idea of an increasingly powerful Chinese economy. One worry is that advances in Chinese technology will make the Middle Kingdom more assertive. When China launched a man into space recently, comparisons with Japan's unimaginative and mismanaged space programme were easy to make.

Besides this vague security threat, Japan also remains anxious about China's growing economic influence in the region. Its recent wooing of South-East Asian countries, where Japanese companies have long held sway, has raised fears of a new Chinese competitive assault in Japan's backyard. During a mid-December summit with South-East Asian leaders in Tokyo, Junichiro Koizumi, Japan's prime minister, will devote some of his energy to countering China's growing economic clout. The Association of South-East Asian Nations, for example, has long pressured Japan to sign its treaty on non-interference in other countries' affairs, without any success. After China agreed to sign it earlier this year, Japan made noises about doing the same.

Mr Koizumi will also try to get South-East Asian leaders to sign up to a new blueprint for tying their economies more closely to Japan's. Yet, although Japan hopes to negotiate bilateral trade agreements with Malaysia, Thailand and the Philippines, those countries want much more freedom to sell farm products to Japan as part of the deal. Alas, hopes that China's growing influence might frighten Japan into abandoning its farm protectionism still seem too much of a stretch.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

India and Pakistan

A break in the clouds

Nov 27th 2003 | DELHI
From The Economist print edition

Great news—but will the ceasefire hold?

AFP

Jamali changes his tune

THE guns fell silent on the long border between India and Pakistan at midnight on November 25th-26th, when the two nuclear powers marked the annual Muslim festival of Eid by beginning their first formal ceasefire for at least 20 years. Proposed on November 23rd by Zafarullah Jamali, Pakistan's prime minister, to apply to the line of control that divides the disputed territory of Kashmir, the ceasefire was extended at India's suggestion to cover the full border, including the remote Siachen Glacier in the Karakoram mountains, which has been a freezing battleground since 1984.

Mr Jamali's initiative took India and most diplomatic observers by surprise. On October 22nd Atal Behari Vajpayee, India's prime minister, had received short shrift from Pakistan when he proposed 12 practical steps for improving relations. Yet just a month later, Mr Jamali was not only announcing a unilateral ceasefire, but also responded positively to several of Mr Vajpayee's October initiatives, including a cross-border bus service in Kashmir, a road route further south, and a restoration of rail and ferry links.

Mr Jamali's change of heart has been described by some western diplomats as the most positive development for years in relations between two countries that have fought three wars since they became independent in 1947, two of them over Kashmir. The initiative probably stems from a variety of pressures, including international criticism of Pakistan's negative reaction to Mr Vajpayee's proposals. Pakistan has also faced mounting criticism from America, Britain and (more privately) China for providing refuge for al-Qaeda and Taliban activists, including terrorists who infiltrate across Pakistan's border into Indian Kashmir.

Pakistan is anxious to ensure that Mr Vajpayee confirms his attendance at a regional South Asian conference in Islamabad early in January. It would however be difficult for Mr Vajpayee to attend the summit without holding bilateral talks—at least with Mr Jamali if not with General Pervez Musharraf, Pakistan's president—and India has been insisting that there can be no such talks till Pakistan stops the cross-border infiltration.

The immediate future of the current initiative—and the ceasefire—therefore primarily depends on the infiltration, which fortuitously always declines at this time of year, when mountain passes are closed by snow. The Indian government has made it clear that, while it has stopped routine shelling of Pakistan military posts, it will fire on any infiltrators that it spots crossing into Kashmir. That could lead to a resumption of hostilities and reduce the chances of the Vajpayee visit taking place. The visit may also depend on progress being made when the two hold talks, on December 1st, on resuming the aviation links currently blocked because of Pakistani reservations.

India will now come under pressure to suspend its operations against militants in Indian Kashmir, which it last did alongside a temporary ceasefire almost three years ago. For the current initiatives to have much longer-term significance, and gradually develop into a peace process, it will also have to move ahead on talks with Kashmiri separatist groups who want some form of autonomy from Delhi, if not independence.

On November 21st, the All-Party Hurriyat Conference, an umbrella organisation of moderate Kashmir

separatist groups, agreed unconditionally to attend a first-ever formal meeting with L.K. Advani, India's deputy prime minister, that was offered alongside Mr Vajpayee's October 22nd initiative. This meeting is expected to take place early in December—but is already being criticised by a hardline breakaway Hurriyat faction that, significantly, Mr Jamali has recently recognised. The real proof of Pakistan's new interest in peace would be if it let the Hurriyat moderates make progress with the Indian government without fearing retribution from the hardliners. In the past, moderates have met with assassination. It must be different this time.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Bangladesh's religious minorities

Safe only in the departure lounge

Nov 27th 2003 | DHAKA
From The Economist print edition

Murder, intimidation and fear of more to come

Get article background

RELIGIOUS minorities in Bangladesh, an overwhelmingly Muslim country of 130m people, have been getting increasingly nervous lately. In mid-November, 11 Hindus were killed near the southern port of Chittagong when their house was burnt down. The main opposition party, the Awami League, claims that the massacre was designed to scare Hindus into fleeing the country. “It's been a pattern ever since the government came to power over two years ago,” says Abdur Razzak, a League spokesman. According to Mr Razzak, hundreds of Hindus have already left.

Muslim minorities are not spared either. A few days after the Chittagong massacre, a mosque in Dhaka attended by the Ahmadiya community was attacked by hard-line Sunnis who say the sect should be declared non-Muslim and banned from worshipping. At least 50 people were injured.

At the same time, members of Bangladesh's 45 mostly Christian or animist indigenous groups have been demonstrating against what they say is the encroachment of Bengali settlers into their ancestral homelands in the north and south-east. The protestors are especially angry over government plans to build a giant wall in the lands of the Garo people in the Madhapur National Park, which they argue will separate them from their traditional hunting grounds and farmland.

Government ministers nonetheless insist that Bangladesh is a picture of communal harmony, especially when compared to India. They cite a heavy police presence during recent disturbances as proof of their intention to protect the Ahmadiyas. And the environment minister says the wall in the Madhapur Park is needed to protect the remaining forest and stop poaching. But the minorities remain unreassured. “The only place where we can be truly safe”, says a Chittagong Hindu, “is in the departure lounge of Zia International airport.”

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Pakistan's North-West Frontier

Making a virtue of necessity

Nov 27th 2003 | PESHAWAR
From The Economist print edition

Politics and Islam in the Frontier

THE trickle of suspiciously large-bellied men emerging from the fifth floor of Peshawar's poshest hotel has dried up. The Gulbar bar, which supplied the bottles that bulged midriffs beneath their *salwar kameez*, the baggy costumes worn almost universally in Pakistan, has shut its doors. Licensed to sell alcohol—supposedly only to non-Muslim foreigners—the gloomy night-spot fell foul of the province's Islamic government, elected a year ago.

AP

The Peshawar cover-up

As an example of the new government's policies, the Gulbar's closure is trivial but far from untypical. The administration has concentrated on petty, rather vindictive, measures to demonstrate its Islamist credentials. Taken together, they amount to a creeping Islamisation of Pakistan's North-West Frontier Province (NWFP), which borders Afghanistan. But the enforcement of virtue is a sign less of a tide of any great religious fervour sweeping the province than of the provincial government's political weakness.

NWFP is one of the two Pakistani provinces (there are four all told) whose government is controlled by the Muttahida Majlis-i-Amal (MMA), an alliance of six Islamist parties. It won power in the state on the strength of its anti-Americanism. This appeals to the Pushtun people of NWFP, who saw the war in Afghanistan as an assault on their ethnic kin, and the one in Iraq as an attack on their religion. But the MMA's manifesto also promised some of the social restrictions imposed by the ousted Afghan regime of the Taliban, whose “ideal Islamic system” has been praised by Fazlur Rehman, one of the most important MMA leaders.

Sure enough, some Islamic norms have been imposed. Advertising hoardings showing unveiled women have been demolished or defaced. Musicians have been harassed, and music banned from public buses. Schools have been told to stock up on Islamic texts and to replace western uniforms with *salwar kameez*. During Ramadan, prayers were compulsory in government offices, and the local Bank of Khyber has promised to start offering Islamic, “interest-free”, banking. Peshawar's only cultural centre, used for drama and music, is reported to have been closed.

Back in June, the government declared a public holiday to celebrate its proudest achievement, the passage through the provincial assembly of a bill introducing Islamic *sharia* law.

“Just for show” is how all this is summed up by Ahmad Khan Sherpao, a former chief minister of NWFP, now minister of water and power in the federal government. The *sharia* bill, he points out, is a straight copy of one presented to the National Assembly, without ever becoming law, by Nawaz Sharif, a former prime minister. Many see its introduction as largely a symbolic gesture.

Similarly, many critics of the government dismiss its other measures as cheap popularity stunts. They also, with some justification, say they are highly unpopular. The paradox is partly explained by the town-country divide. In the cramped, labyrinthine alleys of Peshawar's bazaar, bearded traders grumble about the government. Long-distance bus drivers recently staged a token hunger strike against the music ban. Some now use headphones, which they unplug from their cassette players with a triumphant flourish as they reach the provincial border.

The core of the MMA's support, however, is in the villages, and the alliance needs to shore up this support against a number of challenges. It is internally divided. Already, the chief minister has had to agree to double the size of his cabinet to mollify smaller parties. The government is also at odds with the federal authorities, unable to stop them providing assistance to American soldiers in their hunt for Taliban and al-Qaeda remnants along the Afghan border. The federal government has cracked down on organisations thought to encourage violence and religious hatred and banned three more Islamic groups this month, which the MMA strongly condemned. Nor has the local government done much to revive the local economy, plagued by unemployment and poverty.

Some MMA assembly members seem increasingly happy to have moved from mosque to parliament, and are keen to stay there. This worries local charities, especially those working with women, which have already been subject to harassment. One plank of the MMA's platform is segregated education, which in many areas is likely to mean no education at all for girls. The MMA has also been alarmingly ready to enforce its policies through extra-judicial thuggery and vandalism.

Many of its members, it is true, are moderates, keen to stress that they have learnt the folly of extremism from the Taliban. Yet the MMA is also threatening to pass a “Hasba” act to give teeth to its Islamic code by setting up a separate legal authority under a religious leader with the power to overrule the provincial assembly. That could provoke a showdown with the opposition and the federal government. It would also raise hackles among many more NWFP residents than those few genial souls in search of a drink.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Iran's nuclear secrets

Coaxing Iran to come clean

Nov 27th 2003
From The Economist print edition

This week saw progress, but there is still a long way to go

A GOOD day for “peace, multilateralism and non-proliferation”? So concluded Mohamed ElBaradei, director-general of the International Atomic Energy Agency (IAEA), after his 35-nation governing board agreed unanimously on November 26th “strongly” to deplore Iran's 18-year record of illicit nuclear dabbling—especially its undeclared enrichment of uranium and separation of plutonium—but not to refer those transgressions to the UN Security Council. Or, at least, not yet.

This week's compromise, haggled out between America and a European trio of Britain, France and Germany, leaves the agency's inspectors, armed with Iran's assurances of full co-operation and transparency, with the task of checking what Iran insists is this time the full story of a nuclear programme it claims to be entirely peaceful. But Iran's nuclear intentions are still open to doubt, as is the continued unanimity of the IAEA.

America, backed by Australia, Canada and Japan, had wanted Iran's violations (this week's resolution talks less accusingly only of “failures and breaches”) of its nuclear safeguards to be put before the Security Council, even if talk of sanctions could wait while Iran's co-operation with inspectors was tested. But the European trio had struck a deal with Iran last month to avoid UN referral in return for suspension of all uranium and plutonium activity and a promise (yet to be fulfilled, sceptics note) to sign up for toughened inspections. Better to encourage co-operation, the trio argued, than to hasten confrontation.

That rather depends on whether Iran has decided to abandon the nuclear-weapon option that its concealed nuclear experiments seemed designed to support. Disquiet about its intentions, both among other Europeans and some of Iran's erstwhile allies in the non-aligned movement, helped stiffen this week's resolution. Should any further “serious” failures come to light, the IAEA's board will still have “all options at its disposal”—code for future Security Council action.

Will this keep Iran honest? Perhaps. Iran is keen to avoid UN sanctions, which would hurt its economy, and to evade military action: something America has not yet threatened, but which Israel was said to be contemplating while Iran was still lying about its nuclear activity.

Much now depends on whether the pile of documents that Iran handed over to the IAEA last month fully accounts for its nuclear programme. Inspectors are particularly keen to discover the origin, whether

inside Iran or outside, of the many different isotopic traces of uranium, some enriched well beyond the level needed for civilian use, that they have already found at different sites inside the country. Iran blames imported centrifuge and laser-enrichment equipment, so inspectors will be following the trail to other countries: they won't say which, though China, Russia and Pakistan are thought to be on the list, as well as companies in Europe. Uncovering Iran's supply network could help stem further proliferation.

However, some Iran-watchers still suspect that Iran may also have illegally imported enriched uranium directly via the black market, possibly from Russia. If so, Iran would quickly find itself back in the dock and this time with scant diplomatic cover from the European trio—all of whom earlier this year signed up to a tough new European Union strategy to curb the spread of weapons of mass destruction.

America's secretary of state, Colin Powell, professed himself pleased that concerted co-operation—from America, the Europeans, Japan and even Russia, which made clear that it would not complete the nuclear reactor it is building for Iran at Bushehr unless the inspectors were satisfied—has pushed Iran to submit to vigorous inspection.

All the better if it can be persuaded to drop, verifiably and permanently, all further plans for uranium enrichment and plutonium separation—the two technologies that could be misused for nuclear bomb-building. That would help the search for a better non-proliferation bargain, one that draws a clearer line between acceptable civilian nuclear pursuits and unacceptable potential military ones.

Iran would probably demand, as part of a final deal, that America lift its economic sanctions. America, for its part, insists that Iran should stop supporting groups that use violence against Israel. All a long way from this week's diplomacy at the IAEA. But that is roughly what it will take to secure peace.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Human rights in Iran

Small mercies

Nov 27th 2003 | TEHRAN
From The Economist print edition

The UN's censure of Iran's human-rights record is not entirely fair

AFP

Who killed Zahra Kazemi?

NO ONE yet knows precisely who killed Zahra Kazemi. The Canadian-Iranian journalist died in July, after a violent beating, while held in custody in Tehran. Since then, the Iranian intelligence ministry, the prosecutor's office and a parliamentary committee have been squabbling over who was to blame. And the Canadian government, unusually, lost patience and tabled a UN resolution, a draft of which was passed last week, denouncing Iran for using torture and suppressing freedom of expression.

Iran's ruling theocracy had imagined that its image was on the mend. In 2002 the UN failed, for the first time in 18 years, to censure its human-rights record. In return, President Muhammad Khatami's government began to talk more about human rights with foreigners, and allowed UN monitors to interview political prisoners. A moratorium on the stoning of adulteresses seemed to be holding. So why, a year on, did no fewer than 73 countries support Canada's resolution?

Because they feel hoodwinked by unfulfilled promises of reform. Time and again, foreigners have urged Iran's judiciary to, say, give detainees immediate access to a lawyer—something they are currently denied—and to end the use of unconstitutional courts to try political defendants behind closed doors. They have received only polite assurances.

Iran's fractured politics are partly to blame. The reformist government and parliament cannot curb human-rights violations without co-operation from the conservative judiciary, which tramples on rights precisely to silence reformists. Tehran's political prisoners, 35 or so of them, are all being punished for propagating or supporting reformist ideas. Of the roughly 100 publications banned since 2000, all but a handful were pro-reform.

Yet the impression that Mr Khatami's six years in office have not improved Iran is not quite fair. True, a conservative-dominated upper house has vetoed most enlightened legislation, such as Iran's adherence to a UN anti-torture convention and the expansion of trial by jury. Outrages still occur; four months after their arrest, the lawyer for three dissidents still has no idea what, if anything, his clients have been charged with. But Mr Khatami's bent for accountability has forced many state organs to behave better.

Gone are the days when state-employed fanatics murdered dissidents; under Mr Khatami, the intelligence ministry has been purged of bad types, and the minister occasionally takes judges to task for their wilder accusations. Although interrogators remain adept at using psychological pressure to extract “confessions”, physical torture is now rare. In some ways, Ms Kazemi's death is an aberration.

The best hope for justice in her case, and in others, may lie in the behind-the-scenes influence wielded by the president and his allies, who may be the reason why only a handful of the 4,000 demonstrators arrested this summer remain behind bars. But if the reformists lose their grip on parliament after next spring's elections, things could get tougher for dissidents. Canada's resolution, though it ignores small mercies now, may have the virtue of prescience.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Iraq

Dangers of the inquisition

Nov 27th 2003 | BAGHDAD
From The Economist print edition

How deBaathification is helping the rebels

Get article background

WHEN Iraq's republicans overthrew the monarchy in 1958, they killed the king and some of his relations and courtiers, declared martial law for a day, and, according to legend, had the theatres open again by the following afternoon. American-run Iraq has not been so smooth. Paul Bremer, the American administrator, arrived in Iraq intent on applying the methods of deNazification, used in Germany after the second world war, to the 2m-strong Baath party, which ruled through terror for 35 years. Some observers fear that it has turned into an inquisition, alienating Iraqis not previously opposed to the occupying force.

Under Mr Bremer's decree of May 16th, some 20,000 alleged members of the party's three senior ranks were summarily sacked from their posts. The information and defence ministries were scrapped, along with their hundreds of thousands of workers. The education minister, a member of al-Dawa, a Shia party banned by the former regime, has reportedly sacked 28,000 teachers on top of those already purged by Mr Bremer. A swathe of technocrats who had supported the regime were cast off. DeBaathification appears to have gone some way towards dismantling a state that had been left largely intact by the unexpectedly swift war.

But some of Iraq's returning exiles, who dominate the American-appointed Governing Council, say Mr Bremer's edict was too soft. Many Baathists still hide in the woodwork, says the council's committee for deBaathification, which has proclaimed round two of the purge. “They changed their identities and fiddled their files on the eve of war,” says the telecommunications minister, Haider Abadi, whose family still lives in London. The committee wants to expropriate the wealth of Baath cronies “for the Iraqi people”, and ban businessmen believed to have links with the former regime from being awarded contracts.

Baathists are not obvious magnets of sympathy. Some are thugs; all enjoyed privileges denied to ordinary Iraqis. The tens of thousands of them now losing their jobs pale into comparison with the millions that Saddam Hussein and his cohorts pushed into exile. Nevertheless, pragmatists fear the Governing Council has embarked on a witch hunt.

Its deBaathification committee has assumed the powers of a Star Chamber. By hearing appeals not only of Iraqis stripped of their jobs, but of businessmen divested of their contracts, it is feared the process could be used to stifle competition. Under the chairmanship of Ahmed Chalabi, a prominent businessman and darling of Pentagon hawks, the committee has begun an investigation into Nadhmi Auchi, an Iraqi-born British businessmen who accumulated much of his wealth under the former regime.

“All those who benefited from the previous regime have to be prevented from gaining any more business,” says Mudhar Shawqat, Mr Chalabi's leading strategist. Mr Shawqat is a shareholder in a consortium awarded a contract to provide a mobile phone service to southern Iraq, and a rival of Orascom, which holds the tender for central Iraq and in which Mr Auchi is believed to hold shares (see article).

Victims of deBaathification complain of rough justice, and American army commanders fear the policy is deepening a cleavage between the newly dominant exiles and Iraqis who found a way of surviving under Saddam. Jobless and humiliated Baathist technocrats have found succour in the arms of the anti-American opposition, say commanders, and are passing information on the most vulnerable pipelines and power cables to the rebels.

From his marble palace in Mosul, a northern Sunni city whence many Baathists hail, America's independent-minded General David Petraeus has circumvented the rules by making dismissals probationary. “You can't fire 900 of 22,000 teachers and give them no incentive to support the interim government,” he says. Last week Mr Chalabi paid him a visit.

Even some of the exiles fear an excess of deBaathification. Ayad Alaoui, a member of the Governing Council, says its deBaathification committee is unwittingly winning the Baathists new recruits. “The party was history,” he says. “We are bringing it back to life.” In an attempt to let bygones be bygones, his brother-in-law, Nouri Badran, who runs the interior ministry, hopes to recruit 200,000 Iraqis, including ex-soldiers and petty Baathists, into the various security forces.

Had Iraqis really wanted to come to terms with the past, rather than just settle old scores, it might have been better if the Governing Council had opted for a “truth and reconciliation” commission, as pioneered in South Africa, rather than a Shia-led inquisition.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Games in Iraq

The ancient art of deception

Nov 27th 2003 | BAGHDAD
From The Economist print edition

Iraqis are brilliant hiders and seekers, even when it's just for fun

AS AN aid to hunting Baathist fugitives, the Pentagon devised a poker deck featuring Saddam Hussein as the ace of spades. But America's sleuths might do better to borrow their methods from Iraq's own favourite parlour game, which is known as *mahabis* (rhyming with cannabis).

It takes a rather large parlour to stage a proper *mahabis* match, so the game is often played outdoors, traditionally during the long nights of Ramadan. The object is to find a hidden *mahbas*, or signet ring. Two teams, each numbering from 50 to 250 and seated in rows, face each other, taking turns to conceal the ring. The team leader, or sheikh, starts an innings by passing in front of his own team. With a blanket covering his hands, he stops in front of each player. When the pass is done, all players remain seated with closed fists in their lap, but only one holds the ring.

The fun begins when the rival sheikh approaches to scour the faces of his opponents. The sheikh can eliminate as many players as he wants, but he has only one chance to pick the exact hand that is holding the *mahbas*. If he chooses wrongly, his team loses a point and the ring stays with the successfully deceitful team for another round. The first team to lose 20 points loses the whole thing. Simple as the game sounds, the sheikh's task requires skill, cunning, a penetrating knowledge of human nature and immense powers of observation.

Before the war, the government itself ran a national *mahabis* tournament, with the finals beamed live on state television. Iraq's current troubles have made it hard to arrange such a large-scale event this year, but in Baghdad, at least, rival neighbourhoods still tussle.

At a youth club in the Karada district, local boys face visitors from Dora, across the river. Fadhil Abbas, Karada's burly captain, is all ferocity, nostrils blasting thick shafts of cigarette smoke as he stalks Dora's ranks. “You lot, out,” he barks, sending off 20 players. A few minutes later he has dismissed all but four, and they have scarcely settled down before Mr Abbas lunges at one of them, so startling him that he cries out as his tormentor triumphantly extracts the ring.

The trick, explains Mr Abbas, is to understand that the eyes which stayed watchful, rather than relaxing, in the instant after he declared that only four players remained were the eyes of the ring-holder. Asked if his talents might be used for hunting down Saddam Hussein, he just grins and shakes his head.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Israelis and Palestinians

A silent, moderate majority

Nov 27th 2003
From The Economist print edition

A new poll suggests most Israelis and Palestinians are quite reasonable

BOTH sides, it seems, are less extreme than their leaders. As part of a new opinion poll, commissioned by the James A. Baker III Insititute for Public Policy in Texas and the Brussels-based International Crisis Group, 600 Israelis and 600 Palestinians were asked what they thought of a hypothetical six-point proposal for a final peace settlement. Some 53% of the Israelis and 56% of the Palestinians said they would support it.

The deal would have created a Palestinian state in most of the West Bank and Gaza, with Israel retaining some Jewish settlements, but surrendering an equivalent area of its own land. Jerusalem was to be divided along current ethnic lines, but serve as the capital of both states, with guaranteed access for all to holy sites. Palestinian refugees were to be allowed to settle in the new Palestinian state, and were to receive compensation, but would forgo a “right of return” to Israel proper.

Sounds familiar? It should. The hypothetical deal is pretty much the same as the one the two sides came close to concluding at the beginning of 2001, before the Palestinians' *intifada* swept the Labour government of Ehud Barak from office and catapulted Ariel Sharon into power in Israel. The proposal also closely resembles two more recent grass-roots initiatives.

One is a petition, drafted by the former Israeli security chief, Ami Ayalon, and Sari Nusseibeh, a Palestinian academic, that has gained 120,000 Israeli and 65,000 Palestinian signatures, as well as friendly nods from the likes of the UN secretary-general, Kofi Annan, and America's deputy defence secretary, Paul Wolfowitz. The other is a more detailed plan, sponsored by prominent Israeli and Palestinian doves, known as the Geneva accord. In the build-up to a public signing ceremony scheduled for December 1st, the accord's backers mailed copies of the 50-page plan to every Israeli home, and have had it distributed with Palestinian newspapers.

The Israeli government and hardline Palestinians heap scorn on both initiatives, but there are signs that others are tiring of their intransigence. This week, America cut $290m of loan guarantees to Israel in protest at its construction of a security wall that cuts deep into the occupied West Bank. The Israeli government dismissed the move as of no consequence. But the poll demonstrates a popular appetite for compromise, on both sides.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Kenya, corruption and the IMF

Dirt out, cash in

Nov 27th 2003 | NAIROBI
From The Economist print edition

Kenya's anti-corruption campaign is wooing back donors

THE finance minister was reportedly overheard whistling “Pennies from Heaven” in the gents. Share prices jumped to their highest level in four years. Last week, the IMF agreed to resume lending to Kenya, and Kenyans are feeling chuffed.

It is not the money itself, though $252.8m over the next three years will come in handy. It is the seal of approval that matters. Save for a five-month reprieve in 2000, the IMF had frozen lending since 1997, citing the grotesque corruption of the regime of Daniel arap Moi. Other donors followed suit, as they usually do, and the economy foundered.

Then, in December last year, a new president, Mwai Kibaki, was elected, who promised to end corruption and restore the rule of law. His government rushed through legislation to form an anti-corruption commission and to force public servants, including politicians, to declare their wealth. His most eye-catching reform, however, is a purge of the judiciary.

Kenya's legal system has been the butt of derision since the late 1980s, when the chief justice took his trousers off, balanced a shoe on his head and goose-stepped around the high-court car park chanting pro-government slogans. While Mr Moi was president, the wealthy bought justice and the well-connected got it free. Those who could not bribe their way out of jail languished there. “Why hire a lawyer when you can buy a judge?” joked Kenyans, miserably.

Mr Kibaki says he wants to change all this. In October, he suspended half of the 12-man appeal court, and 17 of the high court's 44 judges. Eighty-two of the country's 254 magistrates have also been sent home. He had good cause, it seems: an official inquiry revealed what some judges charge for favourable verdicts: $250 to escape a rape charge, and $500 for murder. Civil disputes apparently cost more: up to $20,000 to win a case in the high court, and as much as $190,000 for one in the appeal court.

Some judges allegedly demanded sexual favours from litigants. One allegedly picked up suitcases of cash bribes from the underground car park of Nairobi's Hilton hotel. On a pettier level, magistrates appear to have terrorised communities with impunity. One allegedly sent a police officer to prison for not bowing to him in the grocers. “Bleaker than Bleak House,” one newspaper columnist wrote after reading the report. But its findings were consistent with previous research. Sources close to a Commonwealth legal panel that investigated Kenya's judiciary last year said that only three of the country's 310 judges were neither corrupt nor incompetent.

Foreign donors, impressed with the purge, are already starting to defrost their aid programmes. They should be cautious, however. The new anti-corruption law may look pretty on paper, but putting it into practice may be difficult.

Does Mr Kibaki have the stomach to push through painful reforms? Donors have demanded that he trim the civil service, one of the largest in Africa, and cut public spending, which will not go down well with Kenyan MPs, who are among the best-paid in the world. Procedures for awarding public procurement contracts, a rich source of corruption in the past, will have to be reformed, and there is frustration at the slow pace of privatisation.

The government's commitment to change is unclear. Critics say it has been selective about which crooks to pursue. While some of Mr Moi's former cronies have been tackled with vigour, current cabinet ministers who allegedly abused tendering procedures have not been taken to task. Four of the suspended appeal court judges ruled against a petition Mr Kibaki filed when he was an opposition leader, challenging

Mr Moi's election victory in 1997. Several equally iffy judges were not mentioned in the government's report.

Replacements for those who resigned were chosen by members of the “Mount Kenya Mafia”, a cabal of ministers and mates from the president's Kikuyu tribe, who reputedly control the government. This group represents a threat to Kenya's chances of ethnic unity and real democracy. It has repeatedly antagonised other tribes and is now attempting to force out Yash Pal Ghai, the respected chairman of a conference charged with drafting a new constitution for Kenya.

The Mount Kenya Mafia is apparently determined that Mr Kibaki should not surrender any of the vast powers the presidency has accumulated since independence in 1963 to Raila Odinga, a member of the rival Luo tribe. Mr Odinga was promised, as the price of his support for Mr Kibaki's party in the election last year, the position of executive prime minister once the new constitution is in place.

Many people are urging Mr Kibaki to curb the Mount Kenya Mafia—a forthcoming cabinet reshuffle will be scrutinised to see if he has. Some donors are thought to have asked Mr Kibaki to sack the education minister, George Saitoti, a hangover from the Moi era, and to demote Chris Murungaru, the inept but powerful internal security minister who heads the Mount Kenya group.

If Mr Kibaki can keep the donors happy, it will help fill a cavernous hole in the budget, currently running at about 5% of GDP. But in other ways, the outlook is less than rosy. Kenya's economy is expected to grow by a feeble 1% this year.

Foreign investors, while welcoming the donors' return, are unfortunately in no hurry to return themselves. Multinational companies have reported a 25% decrease in turnover this year. Horrifyingly violent crime, particularly in the capital, is not encouraging newcomers and there are concerns over the government's foolishly populist recent promise to reduce the 25,000-strong expatriate workforce by two thirds, to “create jobs” for locals. As if Kenya needed fewer skills.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Award

Nov 27th 2003

James Astill, our former Nairobi correspondent, and Robert Guest, our Africa editor, have won Britain's Foreign Press Association Financial Story of the Year award for their article on the economics of civil war (May 24th, 2003).

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

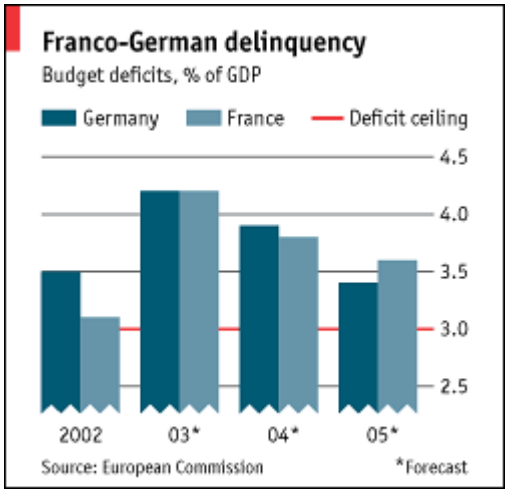
Europe and the euro

The death of the stability pact

Nov 27th 2003 | BRUSSELS
From The Economist print edition

It could be good news in the short term, but bad in the long run

DEAD, sleeping, or in the refrigerator? All these descriptions were applied to the European Union's "stability and growth pact" this week, after a majority of EU finance ministers refused on November 25th to press ahead with the sanctions envisaged under the pact for France and Germany as punishment for running "excessive" budget deficits. The European Commission had recommended that the rules be applied to the two miscreants, both of which will break the deficit ceiling of 3% of GDP for a third year running in 2004 (see chart), and both of which had refused to make the further cuts that the commission demanded.



Had the commission's recommendation been approved, France and Germany would have been forced to make those cuts. If they had refused or failed to do so, the next step would have been to levy deposits, later converted into fines, that could have run to billions of euros. Unable to accept such strictures, and jibbing anyway at the whole notion of Brussels running their national budgets, the French and Germans persuaded enough other countries to support them in rejecting the commission's proposals. The excessive-deficit procedure against the two has been "suspended".

Gerrit Zalm, the Dutch finance minister, who, along with his Austrian, Finnish and Spanish counterparts, voted for the commission proposals, protested that some small countries had been intimidated by France and Germany. He predicted that all 12 members of the euro would now pay the price of French and German fiscal incontinence. The commission is muttering about the possibility of mounting a legal challenge to the ministers' decision. But whatever happens, it seems clear that the sanctions mechanism—which was supposed to be the underpinning of the stability pact—has now become unenforceable.

Does this matter? In the long run, the question that Mr Zalm raises is certainly troubling. How can the euro-area stop fiscal irresponsibility in one country damaging others? And beyond the economics, there is a political problem. The EU is a "community of laws". It is soon to adopt a constitution full of solemn and legally binding commitments, including the same excessive-deficit procedure that has just been wilfully flouted. If law is replaced by political bargaining, with bigger countries bullying their way out of a tight

corner, the very basis of the Union is undermined. And it makes it far harder to insist on the new EU members who will join next May observing all the rules.

In the short term, however, the economic consequences of the trashing of the pact are more mixed. Defenders of the EU's fiscal rules—including both the commission and the European Central Bank (ECB)—always argued that the credibility of the euro depended on the enforcement of the pact. In the event, the euro rose slightly in foreign-exchange markets on the day the pact was buried. For the moment, the markets seem more worried about a weak dollar and a gigantic current-account deficit in the United States than by any fiscal problems in the euro area.

Moreover, many economists have long argued that it would make no sense to force countries such as Germany and France, already struggling to come out of recession, to cut public spending at this point in the economic cycle. Martin Baily, a former chairman of Bill Clinton's Council of Economic Advisers, calls it “Hoover-era economics”. The consequences of such a policy are already on display in Portugal, which breached the 3% limit in 2001. Under heavy pressure from the EU, the Portuguese slashed public spending and came up with a series of accounting tricks to bring their deficit back under the 3% limit in 2002. But the economy has since fallen into deep recession, tax revenues have fallen—and the budget deficit has, once again, soared out of control. Portugal has just quietly announced that its deficit for 2003 will be 5% of GDP. Francis Mer, the French finance minister, declared this week that too strict an application of the stability pact had forced Portugal into an “irredeemable recession”.

Even so, most economists consider that the euro area still needs a way of persuading countries to control their budget deficits and debts. The problem can only get more acute, because most EU countries face mounting fiscal burdens as their populations age and both pension and health-care obligations increase. The fear is that, without some common rules, countries that make painful reforms may be faced with higher interest rates caused by others' irresponsibility.

The EU has tried to guard against the danger of such pain spreading by inserting a “no bail-out clause” into the treaties that set up the single currency. This means that any country that finds itself unable to pay its debts cannot, in theory, be saved by a loan from the ECB. Again in theory, this should encourage the markets to demand different rates of interest, reflecting the different risks attached to debt issued by different euro-area countries.

Yet, in practice, the markets seem to make little distinction between the debt issued by different euro members, which suggests that investors do not really believe that there would be no bail-outs. One economist points out that the ECB's obligation to intervene to ensure the smooth functioning of credit markets in all euro-area countries could be interpreted as opening the door to possible bail-outs. More generally, it seems unlikely that the euro area would passively let a member country, especially a big one, slide into an Argentina-like default. For better or worse, the economic fates of all single-currency members are now deeply entwined.

An optimistic interpretation would be that the stability pact will now evolve from a rigid rules-based system that is both unrealistic and undesirable into a more flexible instrument that relies more on moral pressure and political understandings. But the difficulty with this idea is that the pact would then be a “gentlemen's agreement” in which some gentlemen seem more equal than others. Few observers doubt that, if Germany had been within the rules and a smaller country had violated them, it would have been the Germans leading the chorus screaming for the rules to be enforced. And the perception that this week's events have once again fostered of there being one rule for big countries and another for the small can only complicate already fraught negotiations on the draft EU constitution.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Turkey after the bombings

An Islamist facing Islamic terrorism

Nov 27th 2003 | ISTANBUL
From The Economist print edition

The prime minister's conundrum

THE juxtaposition of the words “Islam” and “terrorism” was “intolerable”, declared Turkey's prime minister, Tayyip Erdogan, after last week's double round of suicide-bomb attacks in Istanbul. Millions of Turks, who embrace Turkey's brand of moderate Islam, agree. Few approve of al-Qaeda, which took responsibility for the attacks on two Istanbul synagogues and on the British consulate and the local headquarters of HSBC, a London-based bank.

As Turkey responds to its worst-ever terrorist attacks—at least 17 people have been arrested over them—Mr Erdogan must strike a balance between pious supporters and opponents in a pro-secular establishment who say he is still an Islamist at heart. That has been the challenge since his Justice and Development Party swept to power in parliamentary elections a year ago. After all, Mr Erdogan and the co-founders of his party started as openly pro-Islamic and anti-western.

EPA

Erdogan, shades of modernism

No sooner had he won the elections, though, than Mr Erdogan disavowed this Islamist past and pledged allegiance to Turkey's pro-secular, western orientation. The parliament dominated by Mr Erdogan's party has since approved a slew of reforms that have improved Turkey's chances of starting negotiations for European Union membership. In October parliament approved a bill authorising the government to send thousands of troops to serve with the Americans in Iraq—though opposition from Iraq's Governing Council then forced the Americans to withdraw their request for Turkish help. Turkey was thus in many ways a perfect target for al-Qaeda.

The government must take firmer action against local Islamic militant groups if it is to maintain its pro-western secular image on the one hand, while on the other hand avoiding more terrorist attacks. Western diplomats have been alarmed by the preponderance of claims, even in mainstream newspapers, that the CIA and Israel's Mossad spy service were behind the bombings. “It raises the question of whether some members of the government share that view,” comments one.

The other difficulty is how to deal with the terrorist threat without putting democratic reforms on hold. The suicide bombers who carried out the synagogue attacks were identified by Turkish police as ethnic Kurds from the province of Bingol in Turkey's impoverished south-east. The authorities have refused to confirm the identities of those who struck the two British targets. But press reports say they were also Turkish citizens who helped to plan the synagogue attacks. And one was yet another ethnic Kurd from Bingol.

All the bombers are suspected of having links with Hizbullah. This is a shadowy group, with no known connection to its Lebanese namesake, which was covertly backed by Turkish security forces because its main targets in the past have been Kurdish nationalists who were either sympathetic with or active members of the PKK, a group that waged a 15-year separatist insurgency in the south-east.

The PKK called a truce in 1999, after the capture of its leader, Abdullah Ocalan. Having outlived their usefulness, Hizbullah militants themselves became targets of the security forces, in a series of raids throughout Turkey. The group's leader, Huseyin Velioglu, was killed in January 2000. But hundreds of his men escaped across the border into Iran and northern Iraq, where some are thought to have teamed up

with a local Islamist terrorist group formed by Iraqi Kurds, which in turn developed links with al-Qaeda.

It should come as no surprise to the Turkish authorities that the country's worst troublemakers come from the Kurdish provinces in the south-east. The government's recent reforms include measures to enable 14m Kurds to broadcast in their own language and to teach it in privately run courses for the first time. But they have remained only paper reforms so far. Rampant unemployment feeds religious extremism and separatist passions in places such as Bingol, where annual income per head in 2001 was $780, compared with a national average of $2,150. Mr Erdogan has yet to visit any Kurdish provinces as prime minister. It is time he did.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD EUROPE
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Croatia

Backlash

Nov 27th 2003 | ZAGREB
From The Economist print edition

The return of the nationalists

SMALL country in south-eastern Europe has election: government changes. Ever since the bloody break-up of Yugoslavia in the 1990s, Croats have dreamed of the day when their country is like anywhere else. It may happen. Yet its election on November 23rd still produced a surprise. The opposition Croatian Democratic Union, or HDZ, did far better than expected, thrashing the ruling centre-left coalition.

The HDZ is the party that, under Franjo Tudjman, took Croatia out of Yugoslavia and led it through years of fighting. But it was ejected in 2000, discredited by corruption scandals and by its intolerant brand of nationalism, which no longer chimed with the times. Its new head, Ivo Sanader, has purged the party of some hard-core nationalist leaders. Indeed, Mr Sanader now claims that the HDZ is no longer nationalist at all. He wants the world to see it as another Christian Democratic party.

Mr Sanader, who will be the next prime minister, is a former theatre director from Split. He became deputy foreign minister and then head of President Tudjman's office. He speaks four languages, studied in Austria and makes clear that foreign policy is a preoccupation. Among his team are diplomats such as Miomir Zuzul, Croatia's former envoy to Washington, tipped to be the new foreign minister.

Mr Sanader says he wants Croatia to join the European Union in 2007. That is wildly optimistic, but he says he knows of nobody who got anywhere by being pessimistic. And accession soon after 2007 does seem feasible. In the short term, though, Mr Sanader will have to resolve the problem of Ante Gotovina, a Croatian general indicted by the war-crimes tribunal in The Hague. Many Croats regard the general as a hero. The outgoing government was unwilling or unable to arrest him, claiming not to know where he was. A fresh batch of indictments is expected soon; this week, unexpectedly, an indicted Croatian Serb leader from Krajina, Milan Babic, actually appeared in The Hague.

For now, the Gotovina case is crucial. It seems that Mr Sanader recognises that he has no choice but to arrest the general, who, as it happens, had close links with his political enemies. The case has already stalled Croatia's advance towards the EU: its association agreement has been blocked by Britain and the Netherlands. Next year the European Commission must give its opinion on Croatia's application for membership. If Croatia fails this hurdle, it could fall behind Bulgaria and Romania, and it might even have to wait for such laggards as Serbia.

Mr Sanader is now seeking coalition partners to give him the extra few seats he needs for a solid majority in parliament. One likely ally is the conservative Croatian Peasants' Party. Mr Sanader would, however, like to avoid links with another right-wing party that, until recently, glorified Croatia's second world war fascist leaders. More unusually, he is wooing the party of Croatia's remaining Serbs. This would look good to the outside world but might not impress most HDZ members, whom Davor Gjenero, a political analyst, describes as old-style nationalists even if Mr Sanader has moved on.

The economic challenges for the new government will be huge. But Indira Konjhodzic, the World Bank head in Croatia, says a lot has been done already. For example, pension reform is more advanced than in France or Germany. But unemployment is some 18%, rising to 40% for 15-30-year-olds. Judicial and administrative reforms are urgently needed. Croatia has only 4.4m people but a backlog of 1.2m civil cases, including issues over title deeds. “The next four years will be really hectic,” she adds. Mr Sanader will have his work cut out.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Remembering Yugoslavia's war

Twelve years on

Nov 27th 2003 | VUKOVAR
From The Economist print edition

Commemorations in the place where it all began

FOR a week, the night-time fog of Vukovar has been pierced by candles, as Croats mark the anniversary of the fall of the city to the Yugoslav army and Serbian paramilitaries on November 18th 1991. The war after the break-up of Yugoslavia in 1990 began near here: the Bosnian tragedy lay ahead. That November, Serbs rejoiced at Vukovar's "liberation". But since 1999, the city has been back in Croatian hands.

Vukovar was Croatia's Stalingrad. Now much of it has been rebuilt. On weekdays there is a bustle in the streets. But come nightfall or the weekend, the place seems empty. That is almost true. Of 45,000 citizens living in Vukovar before the war, only half remain. Lots of people have had their houses rebuilt but, as there are hardly any jobs, few have come back. Many of those with jobs, mostly in the administration, schools or police, live elsewhere and commute in. Some Serbian policemen, who kept their jobs as part of the deal that ended Serbian control, are actually believed to live in nearby Serbia.

Unemployment is officially some 37%, more than twice the national average. Before the war, Vukovar, set in rich farmland by the Danube, was a wealthy town. But many of its employers were literally blown to bits. The Borovo shoe and tyre factory once employed 23,000. Now only a few hundred work in a partly ruined factory. Farming faces hard times. Cereal growers cannot compete with protected EU crops.

Since this part of once Serb-held Croatia was peacefully reintegrated into Croatia, not reconquered, a big Serb minority remains. The Serb population of Croatia may have dropped to well below half its former level of 600,000, though nobody really knows. It is now easier to return, but finding work remains a big problem. Vukovar's politicians insist that Croats and Serbs do not mix—though locals say different. Old friendships have been rekindled, many Serbs and Croats socialise and there have been some mixed marriages.

In the Vukovar suburb of Borovo Selo, an overwhelmingly Serb area and the scene of one of the first bloody incidents of the war in 1991, the Serbian and Croatian flags fly beside each other at the town hall. The Serbian flag, representing a Croatian "national minority", is legal. Every day five buses arrive from Belgrade; visa requirements between the two countries have been suspended; bilateral trade is on the increase. It makes one wonder what the war was for.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

French universities

Elite syncopations

Nov 27th 2003 | PARIS
From The Economist print edition

Troubles as universities such as Sciences-Po seek to modernise

AFP

Students against change, as usual

IT MUST send a frisson down the spine of any politician who remembers '68. A strike by students has spread to 18 universities. From Rennes to Lyons, students have occupied campuses, blocked lecture halls and staged protests. A panicking government has retreated, reinstated, and then backed down again on part of its plans.

The students' gripe? Neither fees (nominal) nor selection (anyone with a baccalauréat is admitted). Rather, they are cross about plans for more autonomy, plus a new diploma system—a three-year undergraduate degree, followed by a two-year masters—officially meant to align France with the rest of Europe, but actually modelled on America. Such changes, the students say, are a humiliating assault on French diplomas, and a step to commercialisation, if not privatisation.

The new degrees, says Luc Ferry, the education minister, are essential to "fight competition from American universities." But the reality is that France's higher-education system reserves real competition for an elite of grandes écoles, which train very few of France's 2.1m students. Overcrowded, non-selective universities for the rest cannot hope to keep up.

Not that all grandes écoles are modernising. Contrast the Paris Institute of Political Studies ("Sciences-Po") with the National School for Administration (ENA), the postgraduate civil-service academy. Sciences-Po's foreign students, especially Americans, used to be glorified tourists: in town for a left-bank experience, not a diploma. Today, a third of its students are foreign, and three-quarters do a degree. The school already teaches a three-year undergraduate degree, followed by "*un masters*", which attracts Americans. All undergraduates spend a year abroad, and learn two foreign languages; a third of classes are not taught in French. The school even has an affirmative-action programme that has just been ruled unlawful by a Paris court. Inevitably fees have risen.

"It was a question of life or death," says Richard Descoings, the young head of Sciences-Po, who masterminded the overhaul. The school was known mainly as an ante-chamber for ENA. It still supplies 90% of the 60-odd students who go there after a first degree each year. Its alumni list, like ENA's, is a political "Who's Who": Jacques Chirac, Nicolas Sarkozy, Laurent Fabius, Jack Lang, Dominique Strauss-Kahn. But Mr Descoings is now rebranding Sciences-Po as a competitor to America's Ivy League universities or the London School of Economics, with courses ranging from international relations to marketing and (this is France) "management of cultural enterprises". It is planning a journalism school, and offers an MBA.

No such changes are in prospect at ENA, which has trained two of the past three French presidents and seven of the past 12 prime ministers. It was set up by Charles de Gaulle in 1945 to mould the elite, at a time when administration and industry were tightly linked. Today, an ENA graduate's address book still supplies top connections. But the calculation for would-be students has changed. Privatisation and new rules limiting *pantouflage* (shuffling between the civil service and public enterprises) have narrowed options. The prestige of a top American MBA and the strength of such home-grown business grandes écoles as HEC or ESSEC have opened up other routes to top jobs.

ENA faces changes of its own. Teaching will in future be solely in Strasbourg (it is now shared with Paris); and the entrance exam is to be opened to other European Union candidates. Yet the school sticks unapologetically to training for public service, with compulsory internships at a local prefecture and courses on French administrative law and budgetary policy. Even foreign students are civil servants.

Not everybody approves of the Sciences-Po example. In a country that jealously guards the idea of higher education for all, elitism has an awkward place. As he backtracked on his planned reforms, Mr Ferry insisted that “the Sciences-Po model is not the model that should prevail for universities”. Competitive excellence, it seems, is fine—but only for the elite.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

The trials of Italy's prime minister

One down

Nov 27th 2003 | ROME
From The Economist print edition

A verdict on a Berlusconi associate

ITALY'S prime minister, Silvio Berlusconi, says he cannot get a fair trial in Milan because its judges are politicised. A verdict in a Milan court on November 22nd suggests otherwise. His friend and former lawyer, Cesare Previti, got five years in jail on one count of corruption. But he and other defendants were cleared of another charge, also levelled at Mr Berlusconi until a new law gave him immunity from prosecution, of conspiring to buy a court ruling in 1986. The judges dismissed this because, they said, no offence had been committed. Why they reached that conclusion will become clear only when they file reasons for their verdict.

The prime minister's supporters pounced gleefully on this decision. Yet even Mr Berlusconi's lawyers accept that the acquittal of his co-defendants has no bearing on his case. “We're talking about different people,” said one. What is more, the charge of which Mr Previti was found guilty casts serious aspersions on how Mr Berlusconi and his friends did business.

The court heard that, in 1991, $434,404 left a Swiss bank account opened by a boss of Fininvest, the top firm in the Berlusconi group. At first it went to an account held by Mr Previti, and then to one held by Renato Squillante, a Rome judge. Mr Squillante, now retired, got an eight-year sentence. But he and Mr Previti may remain free until their appeals are heard. Mr Previti, defence minister in Mr Berlusconi's first cabinet, is also contesting an earlier, 11-year sentence for judge-bribing.

He might have had a stiffer sentence in the latest trial had it not been for a gap in the statute book. He was convicted of “simple” corruption, not the more serious offence of judicial corruption. When he sent Mr Squillante the cash, judicial corruption applied to receiving, not proffering, bribes. The anomaly was rectified a year later.

Mr Berlusconi's next day of reckoning will be December 9th, when the constitutional court rules on the immunity law. If it is upheld, he has nothing to worry about until he leaves office. Anyway his suspended trial is unlikely to be resumed. So it would have to start again from scratch, and might still be before the courts when the charges become subject to a statute of limitations. The latest trial took four years from indictment to produce an initial verdict.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD EUROPE
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Charlemagne

Those pesky Poles

Nov 27th 2003
From The Economist print edition

In which old members offer new ones some lessons in negotiation

SELFISH, greedy, nationalistic, unEuropean. Not France or Germany, you understand, which have just upset the European Commission and many smaller countries by riding roughshod over the euro's stability pact. No, these insults are being heaped on the poor Poles, as the tortuous negotiations over a new constitution for the European Union lurch towards a conclusion. What have the Poles done to deserve such odium?

The problem is that they are fighting like alley cats for what they see as their national interests. Siren voices in Brussels, Paris and Berlin are warning the Polish government that it is making a terrible mistake. It is a newcomer to the club and has failed to understand its essential feature: the “culture of compromise”. All countries must occasionally sacrifice their national interests to serve the greater European cause. Poland must realise this great truth and buckle under, before it harms both the EU and itself.

The biggest issue causing grief is the proposal in the draft constitution to adopt a new voting system. Under the putative “double majority”, a law would be passed if it won the support of a majority of EU countries, representing 60% of the total population. This would replace the system agreed upon at a summit in Nice in December 2000, in which countries were awarded “weighted votes”. Under the Nice formula, Germany, with a population of over 80m, gets 29 votes, the same number as France, Britain and Italy, each of which has a population of roughly 60m. Poland and Spain, with populations of some 40m each, get 27 votes apiece. In their more candid moments, even the Poles recognise that this system is bizarrely advantageous to them. As a Polish minister once confided to your correspondent, “We have a population half the size of Germany's and an economy about a tenth the size, and yet we get 27 votes to their 29. We would be crazy to turn down a deal like that.”

The EU was certainly crazy to offer a deal like that. That it came up with such a strange voting system was the result of the politics and panic of the moment. Double majority was proposed at Nice, but France, which held the EU presidency at that time, refused to accept the system because it gave Germany relatively more power. The Poles, who were not even at the table in Nice, were the happy beneficiaries of a combination of French intransigence and Spanish negotiating skills.

There is no doubt that “double majority” is more democratic and more comprehensible than the Nice formula. But the Poles have respectable arguments for sticking to their position. The Polish people have just voted to join the EU in a referendum, based on the terms offered to them at Nice. Now, after the vote, and just a few months before Poland's formal entry next May, the EU is belatedly trying to retract its offer. The switch to double majority was proposed by the Convention on the Future of Europe in June, which claimed to be an open and democratic exercise. But the new voting system was decided upon at the last minute by the convention's presidium (steering committee), on which there was no Polish representative. Even at the time, the Poles and the Spanish made it clear they did not accept the idea.

Dogs in mangers

But, beyond the negotiating intricacies, don't the Poles have a moral obligation to accept that Nice is plain silly and that double majority would be better? Surely the EU should be about more than “what we have, we hold”? In an ideal world, undoubtedly. But all the huffing by current members of the EU about the need to think of the “European interest” would be more convincing if they were to apply the same principle to themselves. Where is the European interest in the Franco-German decision to trash the stability pact, simply because the French and Germans cannot control their budget deficits? Where is the

European interest in France's dogged defence of the wasteful and protectionist common agricultural policy, which just happens to shovel huge wads of cash to French farmers? Where is the European interest in Britain's insistence on keeping its budget rebate, no matter what? Or in Spain's relentless determination to cling on to a disproportionate share of EU regional aid?

The Poles, however, are newcomers, and relatively poor at that. As a result, they seem to be expected to mind their manners and just be grateful for all the EU money that will soon head their way. Even when current members try to sound sympathetic, their attitude is deeply condescending. Viscount Etienne Davignon, a Belgian former vice-president of the European Commission, and the epitome of the EU's great and good, says: “We have to remember that the Poles have only recently regained their national sovereignty and are new to the European Union. It takes many years of membership before people really understand how Europe works.” The notion that the Poles and the other seven central European countries that are joining next year (along with Malta and Cyprus) might just possibly have ideas that are as valid as those of the six “founder members” is apparently too fanciful to contemplate.

The fact is that the entry of Poland into the EU is profoundly unsettling to traditionalists. European integration began with Franco-German reconciliation after the second world war. The EU's main institutions are still strung out along the Franco-German borderlands, in Brussels, Luxembourg and Strasbourg. For French and German politicians, it is axiomatic that their relationship should remain the fulcrum around which the EU revolves. But enlargement will shift the centre of gravity. The decision of the Poles (and most other central Europeans) to take a pro-American line over Iraq went down particularly badly in France, prompting Jacques Chirac's now infamous remark that the newcomers had “missed a good opportunity to shut up”. Now that the constitutional negotiations are reaching a crunch, the Poles are again being invited to “shut up”. So far, they have declined the invitation. How very shocking.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD BRITAIN
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Universities

Dons bring in the dough

Nov 27th 2003
From The Economist print edition

The government's plans to reform university funding are being criticised as creeping privatisation. It's happening anyway

Get article background

BRITAIN'S universities straddle two worlds. One consists of full-time undergraduate courses, mainly filled by British students, with costs subsidised (but only partly) by the state. It is depressingly threadbare, overcrowded and politicised. There is government interference galore: to take more poor students in the name of social engineering, to promote particular subjects and courses to meet planners' priorities. Success comes when wily bureaucrats outwit the rulemakers. It reeks of the Soviet planned economy.

The other world is of competition, for staff, students and research money. It is the world of mobile, flexible, go-ahead academics; of foreign, part-time and postgraduate students who have backed their choice of course with their own money, and expect value for it; of private businesses sponsoring research that they think will boost their profits. It is a much more dynamic, tougher but more cheerful place. Advancement comes through excellence, hard work, and ingenuity.

Both worlds can co-exist. Universities will subsidise costly courses out of their other income for altruistic reasons. But not indefinitely: as the differences, in salaries, in quality and in style increase, the strain on the old arrangements grows.

Now comes the crunch. The most controversial part of the government's legislative programme for the coming year is a modest attempt to bring some flexibility to the price-controlled part of higher education. Misleadingly called “top-up fees”, the scheme aims to allow universities to charge up to £3,000 ($5,100) a year for tuition, instead of the current £1,125 flat rate. The cost would be deferred: graduates would repay the loan once they start work.

It is hugely unpopular. Polls show large majorities against it. More than 100 Labour members of Parliament have signed a motion opposing it; both opposition parties, the Liberal Democrats and (with scandalous opportunism) the Conservatives are against it too. Another controversial reform, decentralising hospital management, squeaked through last week with a majority of only 17. It is hard to see the tuition fees going through without big sweeteners, heavy dilution, or both.

But even the contentious top-up fee the government proposes is not nearly high enough to solve the universities' problem. Top universities reckon it costs around £8,000 a year to teach an undergraduate, more in sciences. Whether the government's plan passes or fails, go-getting universities will accelerate their efforts to raise money independently.

One source is more of the customers whose fees are mostly set by the university, not the state. Income from overseas students (see chart) has risen sharply, and now brings in £875m annually. That is 7.4% of the entire university sector's annual income—three times more than comes from endowments. It could be a lot higher. China, for example, already sends tens of thousands of students to Britain every year; yet places such as Oxford and Cambridge have barely started marketing there.

Undergraduate teaching will face a squeeze. Some universities may maintain it as a loss-leader, or because the cross-subsidy is bearable. Others will spend as little as possible, relying on lectures

and multiple-choice tests rather than time-consuming essays and seminars, and using cheap graduate students to do the remaining teaching. Standards will fall.

Experience so far also points to a shift in the kind of courses on offer. Students paying full fees are choosier than those who have their courses subsidised by the state. They want MBAs, for example, and taught one-year masters degrees in finance, accountancy and suchlike. Whereas 18% of undergraduates choose creative subjects—humanities and languages, for example—a third fewer opt for these when they get to postgraduate level.

Those market signals will inevitably encourage universities to shift "to high-demand low-cost courses like law and accounting from low-demand high-cost courses like science and engineering," says Ivor Crewe, who heads Universities UK, the main higher education lobby group. Already, several universities have closed their chemistry departments; now biological sciences are under threat. If the government wants to save such subjects, it will have to subsidise them directly.

This is not necessarily the triumph of philistinism: Oxford colleges, for example, report plenty of Americans wanting to study English. But it does mean that universities will have to tailor their courses, and market them, much more nimbly.

Many will find that hard. "I suppose we may have to do an LSE," says one vice-chancellor, gloomily referring to the country's most international and market-driven mainstream academic institution, the London School of Economics. But Sir Howard Davies, formerly the country's top financial regulator and now the LSE's director, points out that such success is hard-won. Academics at the LSE are used to courses being chopped or expanded in the first days of term, depending on registrations. Keeping standards up is tricky: when students are customers, you have to be brave and tough to fail them.

These developments may not be restricted to courses for foreign students and postgraduates. If the government wins, and the market seeps into undergraduate courses, they will go the same way.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Longevity

Dons' delight

Nov 27th 2003
From The Economist print edition

Oxbridge lifestyle helps dons live longer. No kidding

YOU work on the subject that most interests you, mostly at your own pace. The surroundings are beautiful, the colleagues stimulating. You take gentle exercise; there is excellent food and drink. A long-dead philanthropist pays for it all. That, more or less, was the lifestyle of Oxbridge dons for most of the past century. Now a research paper has shown that there is a practical benefit: four years on your life.

The work started as a student project at Cambridge, and is published in *Trends in Ecology and Evolution*. The authors looked at a group of 311 male dons born before 1920 who died aged 60 or older. Their life expectancy at 60, on average, was 19 years, compared with 15.3 for an average male and 16 for men from similar social backgrounds. The only significant factor was being at Cambridge. Academic success, the choice of arts or science, and the wealth of their college were all statistically insignificant.

Other studies of longevity point in the same direction. Victoria Copas, one of the paper's authors, says a Spanish study found that social interaction delayed the onset of neurological diseases associated with old age. Research shows that monks too live longer than average. They miss out on roast swans and claret. But clergy, like the dons, can work until they drop, thus avoiding boredom, that lethal feature of retirement.

Will it continue? Academic life at Oxbridge is much less fun now. There is more bureaucracy, a heavier teaching load, and more pressure to produce published research. The authors wonder, sadly, if the next generation of dons will have their predecessors' longevity.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD BRITAIN
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Whisky

Storm in a whisky barrel

Nov 27th 2003 | EDINBURGH
From The Economist print edition

Diageo has taken on tradition

COMPANY executives have been summoned to meet MPs, questions have been asked of the prime minister, and lawyers are hovering. The row is over a bottle of whisky and what is (depending on where you stand) either a brilliant marketing wheeze or a looming disaster for a big export earner.

Diageo, a big drinks company, is the world's biggest Scotch-whisky-maker. Its brands include Cardhu (pronounced Cardhew), made from malted barley and, traditionally, bottled from a single distillery source. Connoisseurs believe a single malt is better than a blended whisky (a mixture of malt and grain whisky) and so pay more for it. Malt sales have risen steadily by 5.3% a year since 1992 while blended whisky sales have been flat, says Alan Gray, whisky analyst at Sutherlands, a stockbroker. “There still is a lot of opportunity for growth,” he says.

But malt whisky production responds only slowly to changes in demand. Malt whiskies have to be kept in casks for 10-15 years, sometimes longer. A couple of years ago, Diageo realised that it was going to run short of Cardhu, mainly thanks to a big Spanish campaign which helped double sales to 3.3m bottles annually in the last seven years.

So Diageo's best sniffers put together something pretty much the same as Cardhu. Except that only a bit of it is Cardhu, the rest is other malts. Rivals say this is not a malt at all, but a vatted whisky. To their rage Diageo is brazenly selling it under the same Cardhu name, price (£25, $43) and packaging, but as a “pure” rather than a “single” malt.

“It is highly likely consumers will be misled,” fumes Tony Hunt, deputy managing director of William Grant & Sons, makers of Glenfiddich, the biggest-selling malt. He says that if maltophiles decide they are being sold a mongrel rather than a pure-bred, they may give up on malt. Alternatively, Diageo's ploy could have the opposite effect, and the new Cardhu be all too successful. Either way, the market for, say, a 30-year-old Glenfiddich at £110 a bottle may vanish.

Diageo insists that what it is doing will help the industry, claiming that drinkers tend to move eventually to pricier premium malts, which Cardhu isn't. “Our job is to grow Scotch whisky,” says Diageo's Peter Smith. The company is not, he points out, sneaking the change through, but has openly advertised it.

At the root of the row is the Scotch whisky business's domination by multinationals such as Diageo and Pernod Ricard. Diageo's smaller competitors object to its willingness to overturn tradition in the interests of making more money. But marketing innovation is, oddly, traditional to the Scotch whisky market—as is resistance to it. When William Grant & Sons sold the first malt whisky in England in 1963, marketing it as a cut above the rest, rivals thought it an absurd idea.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

The left

George's big adventure

Nov 27th 2003
From The Economist print edition

Leftists and Muslims get together

GEORGE GALLOWAY, MP for Glasgow Kelvin and missing link between Saville Row and international socialism, has kept busy since his expulsion from the Labour Party on October 23rd. Together with other anti-war malcontents, he has been touring the country, building a new political movement. Mr Galloway's vaguely named “unity coalition” does not yet have a manifesto. But it has a website—www.blairout.com—and an ambitious plan: to turn a motley bunch of peaceniks into a disciplined electoral force capable of humbling the government at next year's European and local elections.

To achieve this, the coalition will have to achieve an improbable union between left-wingers, most of whom are determined atheists, and Muslims. Such a goal was unthinkable a year ago, before the Stop the War Coalition began to put bearded men of the Muslim and socialist variety together on the streets of London, together with thousands of others.

Then, in September, the Liberal Democrats overturned a Labour majority of 13,000 in Brent East by plucking Asian Muslims and disgruntled whites out of the Labour camp. Hopes for an alliance between the left and Muslims are now running high: Salma Yaqoob, a Birmingham activist closely involved in the new scheme, talks about forming “the largest progressive block in Britain”.

Whether the devout and the doctrinaire can form a united political front is another matter, though. The leadership of the Socialist Workers' Party—which is, to a large degree, the same as the leadership of the Stop the War Coalition—has tried to help along an alliance with Muslims by retreating from its liberal position on women's and gay rights. Mr Galloway seems happy with that. So, he claims, are other left-wing groups—apart from a few “weirdo Trotskyites”.

But compromise (and language) of this sort does not go down well with the corduroy-jacketed folk who guard the socialist flame. Peter Manson, editor of the *Weekly Worker*, the house paper of the Communist Party of Great Britain, believes that there is an important difference between marching with non-socialists and making common cause with them. He says, bitterly, that the Socialist Workers' Party has shown little interest in turning protesters into true believers: “They were standing in Hyde Park in front of more than a million people, and they have hardly managed to increase their membership since.” The latest outfit strikes him as little more than a marriage of convenience, one that may well damage the socialist cause if it comes unstuck.

Not all Muslims are keen to tie the knot, either. The Muslim Association of Britain (MAB), a grassroots organisation that has worked closely with the Stop the War Coalition, now speaks confidently of the “shared values” of Islam and socialism. But Azzam Tamimi, MAB's chief spokesman, seems to regard Mr Galloway's outfit as a strategic tool to be used among many others, including tactical voting with established parties. And as for familial and social issues, many Muslims find a conservative Christian view of the world more appealing than one based on socialism, however cleverly disguised.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

The BBC

A monitor for the Middle East

Nov 27th 2003
From The Economist print edition

He will watch for balance in the BBC's reporting. Should he exist?

Get article background

BRITISH Jewish groups and the Israeli government have long believed the BBC guilty of anti-Israel bias. The grumbling has grown this year. Now the BBC has appointed a man to monitor its entire Middle East output.

An “extraordinary move”, said the *Jewish Chronicle*, and it is. Has the BBC crumbled under pressure, as some pro-Arabs fear? Or tacitly recognised its sins, as Jewish groups hope? Or simply lost its nerve (and—with Iraq and Downing Street also in mind—remembered the renewal of its charter, due in 2006)? None of these, says the BBC: the move will strengthen its coverage and its relations in the Middle East. And, as it doesn't add, give its journalists some shelter from tireless complaints that the issues there arouse.

Most of the lobbying comes from Israel and its backers. Ariel Sharon's government boycotted the BBC last summer, mainly over its reporting of Palestinian issues, but especially over a documentary on Israel's nuclear potential. Relations have now been restored, in unpublicised talks in Jerusalem and, oddly, Berlin over the past two months. The BBC's appointment of its monitor was part of the two sides' understanding, says an Israeli source. It was swiftly followed last week by an announcement from Israel that the government would resume co-operation.

Britain's pro-Palestinians are worried. They too feel the BBC under-reports their view of the world, and they too lobby; but they think they have less clout. Still, when the Council for the Advancement of Arab-British Understanding met the monitor last week, it was somewhat reassured.

He is Malcolm Balen, at one time a senior BBC news editor. In part, he will act as lightning-rod for complaints. But he cannot investigate them all; nor would its editors long accept someone breathing down their necks. Broadcasting is about quick decisions and short soundbites. These are where the problems start: not lies, but lack of context, as the *Jewish Chronicle* said. “No one can expect any broadcaster to wrap all daily news reports in an encyclopedic view of Mideast history. But...”

Pro-Arabs echo that view almost to the letter, and just as unhappily. Almost any choice of topic, even of word, in reporting the Middle East, reflects a view of history. No monitor, however impartial, can alter that. Rather than appoint one, the BBC could have told its critics that.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Constitutional reform

Lords behaving badly

Nov 27th 2003
From The Economist print edition

Tory peers intend to go out with a bang

Reuters

And another thing

AS IF Tony Blair didn't have enough to put up with from stroppy Labour MPs out to wreck his plans for university top-up fees, he is faced with near-anarchy in the House of Lords, where the government does not enjoy a majority.

Last week, the Lords bared their teeth, threatening to consign to oblivion two big pieces of government legislation as the clock ticked down on the old session of Parliament. At the last gasp, their lordships allowed the government to have its foundation hospitals, but stuck to their guns in demanding the removal of a measure restricting the right to jury trial. The logic was that one was just a policy, but the other concerned a fundamental right that would be lost forever.

The nightmare for Mr Blair is that in the new parliamentary session, the sabotage will be persistent. The reason is that the Tory peers are furious with him. Some time ago, Mr Blair gave what was believed to be a solemn undertaking that the remaining 92 hereditary peers, nearly all of whom take the Conservative whip, would be allowed to continue until the government came up with proposals for reforming the second chamber that included a considerable degree of democratisation.

Mr Blair, argues Lord Strathclyde, the Tory leader in the Lords, has ratted on that deal. When the Commons held a free vote on House of Lords reform in February, Mr Blair let it be known that he now favoured a wholly-appointed second chamber. That was enough to ensure that none of the proposals voted on commanded a majority. Exploiting the stalemate, the government is now pushing ahead with its plans to get rid of the 92 hereditaries and introduce what it describes as an “independent appointments commission”.

Lord Strathclyde says that the government's double-dealing has in effect released the Tory peers from the convention by which the House of Lords does not excessively delay or undermine the government's business. Given that the government is intent on getting rid of them anyway, its threats are meaningless.

The House of Lords reform bill will itself be fought tooth and nail, but that is not the only legislation in peril. Also vulnerable is the constitutional reform bill which will abolish the ancient office of Lord Chancellor, create a supreme court and change the way judges are appointed. The law lords are said to be “irritated beyond belief” and prepared to “make life bloody for the government”.

The government is trying to ignore this sabre-rattling, but it is worried enough not to have included in this week's Queen's Speech a bill to ban fox-hunting. Government business managers were worried that peers would debate the bill until everything else in the legislative programme was in jeopardy. Hell, it seems, hath no fury like a hereditary scorned.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Railways

What price safety?

Nov 27th 2003
From The Economist print edition

What growing fears of safety cost the railways

Get article background

GERALD CORBETT, former boss of Railtrack (now Network Rail), and 11 of his colleagues are facing criminal charges including unlawful killing and breaches of safety regulations as a result of the Hatfield crash three years ago which killed four people. The case does not come to court until 2005, but it is already having a profound impact on the railways.

The railways may well have got safer. But safety comes at a price, in both money and reliability. Safety fears have increased operating costs by at least 20%—roughly £1 billion a year. Network Rail, the track authority, says the railways will not get back to pre-Hatfield levels of punctuality and reliability for a decade.

The government is worried. The transport minister, Kim Howells, has publicly questioned whether the billions of pounds being devoted to rail safety is being well spent. “We have got to change this culture,” he says. “There has got to be a proper public debate.”

Senior rail executives blame the Health and Safety Executive (HSE), the government's safety watchdog. They say the problem stems in part from the signal sent out by the Railtrack prosecution. A former British Rail director points out that if rail managers face a manslaughter charge after every accident, it is not surprising they become excessively risk-averse.

Such signals go all the way down the line. One consequence is that drivers have become more risk-averse, and therefore drive more slowly. The result, not surprisingly, is more late trains. The director-general of the Railway Forum, Adrian Lyons, says the safety culture has become one of punishment and enforcement rather than co-operation.

These concerns are echoed inside the HSE. Alan Osborne was head of its rail safety division until he resigned last month after less than a year in the job. In an unpublished resignation statement, disclosed to *The Economist*, he accuses the HSE of being a “dysfunctional” organisation whose policy and operational arms are at war with one another. This, he says, causes the organisation to send out conflicting messages to the industry. What's more, he maintains, the HSE treats the railways as though they were a “a major hazard industry”, like the nuclear or chemical industries.

An illustration of this point was the HSE's appointment of a nuclear specialist to investigate the Potters Bar derailment in May 2002. The resulting recommendations would, if implemented, have meant years of disruption and cost hundreds of millions of pounds. Industry sources claim that the HSE also requires unnecessary “gold-plating”—for instance, signals on branch lines as complex and expensive as those on main lines.

Bill Callaghan, chairman of the commission which controls the HSE, acknowledges that relationships with the railways are bad. “We have found it difficult to get across that we are not unreasonable,” he says. “No one in the bus or airline industry complains that we are imposing unreasonably high standards.”

But what is reasonable? The Cullen Inquiry into the Ladbroke Grove crash recommended that an advanced European train signalling system should be installed by 2008. The government initially accepted this recommendation, even though it was estimated that it would save an average of two lives a year at a cost of £2 billion. It was only after the Commission for Integrated Transport pointed out that the consequence would be to drive passengers from railways, which are relatively safe, to roads, which

are dangerous, that the proposal was dropped.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Retailing

Christmas at the checkout

Nov 27th 2003
From The Economist print edition

How supermarkets have become department stores

IF YOU want to see the future of British retailing find a big out-of-town Tesco's superstore and watch. More and more, you will see shoppers loading their trolleys not just with food but also with clothes, cosmetics, books, DVDs and electronic goods. After taking a pasting from an unusually hot summer, which badly hit their sales, department stores and many high-street shops are coming to dread a Christmas in which more and more people will buy their presents from supermarkets.

As if to underline the trend, Tesco's boss, Sir Terry Leahy, this week sent his firm's share price soaring with news that in the quarter to November 15th, same-store sales were up by 6.9%. Of greater significance was the faster growth of non-food lines: sales of clothing grew by a remarkable 34%. Some 30,000 pairs of Tesco's Value jeans now walk out of its stores every week, priced at just £4 each—as well as school uniforms, flat-screen TVs and Harry Potter videos.

This is familiar in America, where eight out of ten households shop at Wal-Mart at least once a year. With $245 billion in sales last year, Wal-Mart sells more clothing and personal products than anyone else in America—and it now owns Britain's Asda, Tesco's arch-rival. Largely through its George brand, Asda is the biggest seller of supermarket clothing in Britain.

No wonder Tesco stands in dread of the “Beast of Bentonville”, as Wal-Mart is known after its Arkansas home. Tesco is aggressively cutting prices in order to try to beat Asda/Wal-Mart at its own game. It is not impossible, because the trick in discounting is not simply screwing as much as you can out of your supply chain and cutting prices across the board. What matters is where you cut prices.

People notice price changes to products they buy frequently, such as eggs or disposable nappies. For goods they might pick up as a convenience while in the store, like toothpaste or deodorant, pricing can be less sensitive. Once, really cheap goods used to lure people into the store were called “loss-leaders”; now the practice has been elevated to an art form called price optimisation, complete with experts and computer programs. DemandTec, an American specialist, says that price optimisation has boosted some supermarkets' gross profits by over 15%.

Much of this would come from non-food goods. These can be produced exclusively for a supermarket chain at rock-bottom prices. For instance, in America Wal-Mart recently signed up Levi Strauss to make a range of jeans especially for it. The discounters are getting increasingly brand-conscious: Costco, an American warehouse chain, is now the place to buy a Breitling Aerospace watch for under $2,000. The supermarket buyers also snap up job-lots at knock-down prices. Hence things like mini-TV sets and portable car-fridges appear like will-o'-the-wisps in supermarket aisles only to vanish when they have all been flogged. In this respect, the supermarkets are copying market traders.

What is the effect on other retailers? Sainsbury is reeling in part because it was late expanding into the non-food business. It is trying to catch up and has just appointed Justin King, a former Asda executive who runs Marks & Spencer's food operations, as its new chief executive. When Mr King takes over in the spring, Sainsbury is expected to compete more on price.

Department stores—especially traditional ones such as John Lewis and Marks & Spencer in regional cities—will feel the most pain. They can expect customers, who once relied on them for casual clothing, school uniforms and cosmetics, to defect to the supermarkets.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD BRITAIN
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Carmakers

Take less, give more

Nov 27th 2003
From The Economist print edition

Two big plants have trouble over pay differentials—for very different reasons

WORKERS at MG Rover are angry. The lines at its Longbridge plant in south Birmingham have been stopped for most of this week. A strike? Worse: not enough people are buying MG Rover cars. That's the big worry beneath the row over the self-enrichment of the four entrepreneurs who saved Longbridge in 2000.

The anger and the row are real enough. The plant, then owned by BMW, and its 8,500 jobs, looked doomed until the four, led by John Towers, once Rover's chief executive, bought it—plus a £427m loan from BMW, repayable in 2049—for £10. Under the name of Phoenix, the four, backed by the government and loudly applauded by trade unions and local people, promised to maintain mass production, unlike a rival bidder planning to build sporty cars alone.

They have stuck to that. There are still 6,000 jobs, and by last year the plant's 2000 loss of £378m was down to £95m. But it is still a loss; and workers were shocked this month to learn of a £13m payment into a trust fund for top executives, mainly the original four, plus the new chief executive. “Our members were absolutely fuming,” says a union official, and national leaders of the two big unions involved, Amicus and the Transport and General Workers Union, had a long session with the bosses. They are to get access to Phoenix's books.

The noise has been about fat-cattery. The fund apart, the “Phoenix four” are due for £2.5m apiece when the firm repays a “loan” from them in 2005. They argue that they took risks and put in their own cash. The unions reply that risk-takers who succeed deserve rewards; but for these ones it is “win on the swings, win on the roundabouts.” The workers' pension fund, in contrast, is deep in deficit and the latest pay rise was only 2.5%.

The real fear, though, is of redundancies, maybe 2,000 of them; the unions are already litigating, waving an old Rover promise of “jobs for life”. That will not do them much good if sales—170,000 units in 2001, 149,000 last year—slide further. The firm is importing an Indian-built mini, and has just launched an up-market MG sports saloon. But its mid-range cars are ageing, and it is short of money to develop new ones. Without an alliance—a flirtation with a Chinese firm fell apart last year—this British-owned remnant of a once huge, all-British car group is at risk.

Yet the true danger is not fat-cattery. Look a few miles east to a successful remnant of that group: Land Rover, in Solihull, now owned by Ford. A new Land Rover model is to be built not there but at another of Ford's factories—a Jaguar plant at Halewood, near Liverpool. Pay is higher there, but the workforce, says Ford, is more flexible. Solihull's 8,100 employees know the 1,100 jobs that will be created could have gone to Belgium, not just to Halewood. So, reluctantly, they accept the switch. But they feel that if the future Land Rover workers at Halewood are to get Jaguar-level pay, so should they. Ballot papers for a strike went out on November 28th.

If the result is a strike, the unions may yet regret it. Longbridge or Solihull, a fat pay packet can endure only where it is earned. A thought, retort the unions, that applies no less to the Phoenix four.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Bagehot

The listening prime minister

Nov 27th 2003
From The Economist print edition

As the new session of Parliament begins, Tony Blair goes looking for inspiration

THE past few days have neatly illustrated many of the ways in which life has been going wrong for the government. The scramble to get Parliament to approve making hospitals semi-independent before the end of the old session was humiliating and unseemly. In an attempt to bolster support, the freedom the hospitals were meant to enjoy has been circumscribed almost to the point of irrelevance.

Tony Blair saw the revolt, which reduced the government's majority from 165 to 17, as a direct challenge to his entire public-service reform agenda. It was; but the damage had been done before the vote was even taken. The mutineers—a dismal coalition of the sentimental (old Labour traditionalists), the bitter (mainly former ministers) and the selfish (the vested interests of public-sector unions)—had already demonstrated their ability to thwart the prime minister's intentions.

That was followed by this week's Queen's Speech outlining the government's programme for the next year. A ragbag of tedious and contentious legislation defied all attempts to suggest coherence. There were the usual sensible tidying-up measures, and a sprinkling of worthwhile reforms—to curb domestic violence and ease traffic congestion—and there was one eye-catching idea: a proposal to give every child a small trust fund at birth. But none of the flagship bills is likely to do anything to revive party morale.

The asylum and immigration bill will strike many Labour supporters as illiberal and mean-spirited; getting rid of the 92 hereditary peers without introducing any democratically-elected element to the second chamber will infuriate almost everyone; the new system for selecting judges will be portrayed (albeit wrongly) as an assault on the independence of the judiciary; worst of all, the admirable plans to boost university funding by allowing higher tuition fees to be charged seem doomed already—the Tories' wholly unprincipled opposition could be supported by a rebellion of up to 180 Labour MPs.

The next session of parliament, during which the government will have to fight all these battles, is likely to be the last full session before the general election, expected in spring 2005. It is almost bound to be tetchy and difficult. But Mr Blair's eyes are now firmly fixed beyond that election, and on making his third, and almost certainly last, term as prime minister both happier and more effective. At the Labour Party conference last month, in a rare admission of fault, he promised to become better at consulting. What he envisaged was not a surrender to his critics, but a structured dialogue with the electorate. He said: “This must not just be a discussion between us. Because if we want a government in touch with the party, we must have a party in touch with the people.”

Is there anyone out there?

On November 28th, the government will embark on what it claims will be the most sophisticated consultative exercise in British political history. The first stage will be the distribution of a long questionnaire designed by Matthew Taylor. Mr Taylor was recently borrowed from the IPPR, a modish think-tank, to “re-connect” the government with its supporters.

The 100-or-so questions cover almost every aspect of British social and political life from dealing with anti-social behaviour to making the United Nations more effective. The broad theme will be how society can be made fairer in the future. It is underpinned by a “strategic audit”, a detailed and frank survey examining the state of the nation published earlier this week on the Downing Street website (www.number-10.gov.uk). The government is expecting to get responses from the public by the spring. Mr Blair thinks the exercise will help avoid the kind of rows generated over foundation hospitals and tuition fees: in both cases, the government produced solutions to problems it had failed to explain

existed.

Is this anything more than a desperate measure from a government bewildered by opposition to its existing policies and short of ideas for new ones? The experience from previous exercises with similar aspirations is not encouraging.

After shattering election defeats Neil Kinnock, a former Labour leader, and William Hague, a former Tory leader, each journeyed the length and breadth of the land “listening to Britain”. Both were looking for ways to ditch their more voter-repellent policies, but the meetings with party activists, cranks and single-issue bores did little to help them come up with anything better. Mr Kinnock's successor, John Smith, fared better with his perambulating “Social Justice Commission”. But it too was hijacked by special interest groups.

Mr Blair may also find himself listening to a tiny minority. As the “strategic audit” pointed out, political engagement has become almost exclusively confined to the educated middle classes. Will anyone else fill in Mr Taylor's lengthy forms? A cynic might say that is exactly what Mr Blair is counting on: after all, these are “his people”.

Yet there are things to be said for this new effort to tap into people's views. First, Labour is in government: people may reckon that something could come of telling it what they think. Second, as politics has become less about ideology and more about management, policies have become more complex. If the government had done something like this earlier to explain the thinking behind its health and university reforms, it might just have won greater popular support for them. Third, the internet should, in theory, make this kind of consultative politics both easier and more productive.

Whatever its potential pitfalls, Mr Blair's enthusiasm for this exercise does at least demonstrate a willingness to admit to mistakes and learn from them. That, in itself, deserves praise.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Corporate scandals

Where's Boeing going?

Nov 27th 2003
From The Economist print edition

AP

Another week, another disaster for Boeing, as Airbus soars to new heights

“EITHER you are ethical or you are not. You have to make that decision; all of us do. And there is no in-between.” So says a book on management, “Soaring Through Turbulence: A New Model for Managers Who Want to Succeed in a Changing Business World,” by an aerospace executive, Mike Sears, and a lawyer called Thomas Schweich. On November 24th, as review copies were being circulated, Mr Sears was fired from his job as chief financial officer of Boeing for misconduct. The book is being withdrawn.

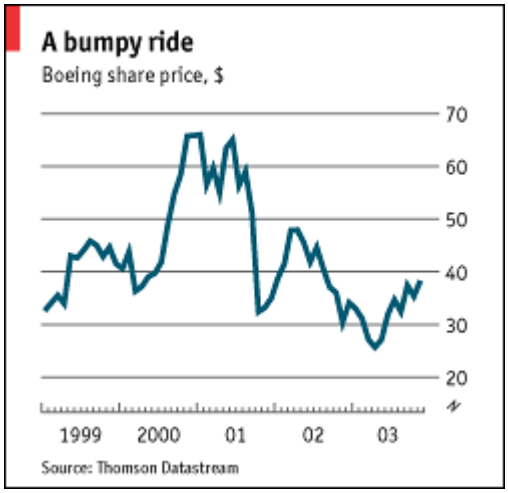
Boeing said the dismissal was for violating company policies by communicating with a government official about future employment at Boeing while she was still dealing with purchases of tanker aircraft from Boeing. Moreover, the firm found that Mr Sears and the official, Darleen Druyun, who later joined Boeing's missile division, had attempted to conceal from an internal inquiry their illicit contacts in September and October last year. Ms Druyun has also been fired.

At first glance, and unless there was worse behaviour yet to emerge, this might seem like summary justice and overkill for a technical breach of the firm's ethics code. After all, if Mr Sears had waited until November, when Ms Druyun recused herself from Boeing dealings at the Pentagon, there would have been no breach. On November 26th, Mr Sears issued a statement denying he had violated company policy.

But following other recent investigations into its defence business, Boeing needs to prove itself whiter than white. And the pair's attempt to cover things up compounded the original offence.

Yet Boeing's share price did not falter (see chart). Perhaps the market has grown accustomed to bad news from America's biggest exporter and the world's biggest aircraft manufacturer. Besides, despite repeated disputes with the Pentagon, the firm still has huge and stable defence contracts, such as the $15 billion “Future Combat Systems” development contract to revamp how American forces fight. Its civil-jet business remains profitable. And overall company profits were down in the latest quarter by only 31%, and full-year figures should hold up quite well, despite huge write-offs

in parts of its business, such as rockets and satellites.



Under investigation

On November 24th, President George Bush signed a bill that includes a $22 billion contract for Boeing to provide the Air Force with 100 air-to-air refuelling tankers. The next day, Donald Rumsfeld, the defence secretary, asked his officials to look again at the deal. The Pentagon's inspector-general is already carrying out an investigation into it. There have been allegations that Ms Druyun passed Boeing information about a bid from Airbus, its rival.

Boeing is growing used to investigations. Last summer it hired a former senator, Warren Rudman, to look into procedures to ensure ethical behaviour at the firm, especially regarding the hiring of government officials. (Incredibly, civil servants can go straight from the Pentagon to the executive suite at firms such as Boeing.)

The Rudman inquiry began after Boeing was found to have acquired 25,000 confidential documents from its rival, Lockheed Martin. Although Boeing fired the two former Lockheed employees involved, it did not return all the documents for years. These employees have been indicted by a grand jury for theft of trade secrets, but the Department of Justice is studying the Lockheed affair with a view to further criminal proceedings, which might involve other Boeing managers. Lockheed has filed a civil suit alleging racketeering, which Boeing contests.

Until now, the firm has claimed that unethical behaviour is limited to the odd junior employee here and there. The real damage from the latest scandal is that it is now seen to reach the highest levels: Mr Sears was widely tipped to become Boeing's next boss.

There is more bad news for Boeing in one of its bleakest years. Airbus will overtake it in the commercial jet market, delivering 300 aircraft against Boeing's 285. And the European firm is also winning more orders in a market beginning to show signs of revival after two years of slump. So far this year, Airbus claims to have won 56% of the 396 orders placed by airlines. By value, Airbus's share is 70% of $37 billion, because it has dramatically outsold Boeing in the valuable wide-body segment. In the jumbo class, Airbus has this year sold 26 of its new A380 555-seater, against only 3 Boeing 747s. It has a backlog of civil orders worth $142 billion, compared with Boeing's $90 billion. Eight years ago, Airbus had only a fifth of the market.

On December 15th, Boeing's board is expected to agree to formally offer airlines its new aircraft, the 7E7. This is a 250-seat replacement for the old 757 and 767 models. Though barely cheaper than the Airbus A330-200 it will compete against, it must succeed if Boeing's credibility with airlines is to be restored. Its two previous offerings, the so-called Sonic Cruiser and a stretched, modernised version of the 747, never materialised because airlines were not interested. Boeing has yet to announce any launch customers for the 7E7. It hopes to get some public expression of interest from Japan Airlines on the eve of the board meeting.

But Boeing is counting on more than orders from the Japanese. A consortium of three firms (arms of Mitsubishi, Kawasaki and Fuji) are to do nearly 40% of the work on the proposed aircraft.

Boeing sub-contracted about a third of the manufacture of its 777 aircraft, its last new model, launched about ten years ago. This time, however, the Japanese companies will be risk-sharing partners, not mere sub-contractors. They have to come up with their share of the $7-billion development cost. The companies have turned to the Japanese government for over $3 billion in subsidy to get the project going. The first money is due to be delivered through an organisation known as the International Aircraft Development Fund.

The Japanese have long sought to develop an aerospace industry. Boeing is now giving them a big leg-up by involving them in making crucial parts, such as wings and fuselage. But Airbus and Europe's trade commissioner, Pascal Lamy, have spotted what is afoot. The European Commission is now investigating whether the Japanese are breaking the terms of a multilateral agreement, now enforced by the World Trade Organisation, to limit subsidies for civil-aircraft production.

How ironic it is that Airbus, which had to fight Boeing's complaints about government subsidy as it hauled itself up, should now complain about Boeing using government subsidy to stop itself falling down.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Offshoring

Lost in translation

Nov 27th 2003 | NEW YORK
From The Economist print edition

Dell's plan to move jobs from India back to America

SO CHARGED have the politics of offshoring become that reports that Dell might move a handful of tasks from its call-centres in India back to America have quickly escalated into a diplomatic incident. Indignant Indians are fuming at the suggestion that it was their “thick accents” and “scripted responses” that persuaded Texas-based Dell to move some customer-service jobs for its corporate customers back to America. In America, protectionist pressure groups are claiming the first victory in a long campaign to bring jobs back home. Even Dell seems divided by the issue. Different statements from different company officials have left outsiders wondering what, exactly, the company plans to do.

On November 22nd, the *Austin American-Statesman*, a local Texan newspaper, ran a story claiming that Dell would be moving some technical-support jobs from India back to its call-centres in Texas. Two days later, the Associated Press confirmed the story. The reason for the move, according to a Dell spokesman quoted by the AP news agency, was that “customers weren't satisfied with the level of support they were receiving.” The following day, a brusque-sounding official at Dell India in Bangalore denied the story. “No, we are not shifting the work,” the spokesperson told PTI, an Indian news agency. As the mystery deepened, further reports suggested Dell's “full commitment” to India, where it employs 2,000 people, and explained all job shifts (if indeed there had been any) as “part of Dell's normal business operations.”

Dell laid off 5,700 workers during the recent tech recession, most of them support staff in Texas. Most of the growth in its workforce since then has been overseas. It may be that its customer service has become genuinely poorer as a result—though multi-regional, multi-racial America has its fair share of different accents, too. Dell may be the victim of well-organised e-mail and bulletin-board campaigns by pressure groups and customers who have allowed their politics to cloud their judgment. Which customers, after all, can claim happy experiences with Texan call-centres? By using Indian ones, Dell does at least keep its computers cheap—which is the main point about its products.

Those Indians who are not now desperately practising their Texan drawl, meanwhile, have begun to plot their revenge. “Imagine what would happen if we moved our techies out of the US back into India,” wonders Arunava Sinha, in a column for the *Economic Times* of India. “Oops. There went Silicon Valley.”

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Music

Better luck this Time?

Nov 27th 2003
From The Economist print edition

A would-be mogul gambles again

EDGAR BRONFMAN has struggled to be taken seriously as a businessman ever since he sold Seagram, the firm his family controlled, to Vivendi, a French conglomerate, for shares worth $34 billion, only to watch nearly 80% of their value evaporate under the leadership of Vivendi's former chief executive, Jean-Marie Messier. More recently he tried and failed to buy back his family's film and music assets from Vivendi in an auction. But this week brought Mr Bronfman better luck (perhaps). Time Warner announced that it would sell its music arm to him and his private-equity backers for $2.6 billion.

AP

Bronfman rings the changes

Time Warner chose Mr Bronfman because it feared it would not get regulatory approval for the deal it preferred, with EMI, a British music firm. Earlier this month Sony and Bertelsmann announced plans to merge their music arms. That spoiled the Warner Music/EMI deal because two mergers would have been far harder to get past antitrust authorities in America and Europe. EMI, which has sought a merger partner twice before, has been jilted again.

Mr Bronfman once predicted that the internet would propel the music industry from a $40 billion business to one worth $100 billion in a decade. Instead, album sales have shrunk by a fifth since 1999, partly because the internet's file-sharing networks have enabled people to get music for nothing. Investors have never been so pessimistic about the industry.

Why, then, would anyone want to bet on Warner Music's future, especially with a generous sum that values the business at a substantial premium to other music firms? To start with, a big chunk of the business is music publishing, which produces cash reliably and is less vulnerable to piracy than recorded music. Overall there is much scope for cost-cutting; Mr Bronfman says he can save $150m a year, and some analysts think he could squeeze out another $100m on top of that by shutting down overseas offices and consolidating music labels. As for recorded music, Mr Bronfman is bravely sticking to his old story that the internet will eventually expand the market once people start paying for music online in large numbers—the success so far of Apple's iTunes bodes well.

Arguably the most interesting aspect of the deal is that big music is going back into private hands. That could be good news, says Michael Nathanson, music analyst at Sanford Bernstein, because the public market's appetite for positive quarterly earnings announcements can be bad for musical creativity: all too often music bosses are pressured to rush artists into producing poor quality albums. “I always think of Hootie and the Blowfish,” says Mr Nathanson. “They had one first great album, rushed back with a second and by the third there was nothing left.”

In the right private hands, he says, music firms could put out fewer but better albums and build rich back-catalogues which they could mine for years. It would also be easier to make the kind of deep cost cuts that many analysts think necessary—including getting rid of artists—outside the scrutiny of public markets, which react badly to falls in revenue and market share.

Mr Bronfman's backers, Thomas H. Lee, Bain Capital and Providence Equity Partners, may think more radically about the future than long-time music executives. If they and Mr Bronfman want to demonstrate realism, they will soon follow the example of Universal Music Group and cut their CD prices. Mr Bronfman and his backers may be cannily buying at the bottom with a rebound on the way, says Lawrence Haverty of State Street Research. Winning such a big, contrarian bet would restore Mr

Bronfman's swagger. Alas, losing would be more true to form.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Business in Iraq

Number unobtainable

Nov 27th 2003 | BAGHDAD
From The Economist print edition

Mobile phones have got Iraq's reconstruction off to an awful start

Get article background

IN JUNE, some Baghdadis received a mobile-phone message welcoming them to Vodafone. They are still awaiting a connection. The Americans running Iraq ordered the phone provider, Bahrain's Batelco, to withdraw and seek a licence.

At least Batelco proved that infrastructure is not the reason why Iraq's phones are still silent. Indeed, the Pentagon proved that, too. It paid MCI $60m to set up a private mobile-network now used by 10,000 of its favourites—and even gave Baghdad a New York area code. The real problem is infighting, egotism and possibly corruption. The result: a sorry indictment of American-led reconstruction.

In October, after much delay, Haider Abadi, the Iraqi communications minister, announced the winners of three regional tenders to provide mobile-phone services. But instead of handing out the licences, the minister and the Coalition Provisional Authority (CPA) started to fight over who had the proper authority to sign them.

Few areas of reconstruction are as vital to Iraq as mobile phones. Many of the country's exchanges linking Iraq's decrepit landlines were destroyed during the war. Under Saddam Hussein and United Nations' sanctions, mobile phones were banned. Making mobile phones available fast could have boosted support for the new regime.

Concerned at the mess, and lobbied by American firms, the Pentagon intervened. It began an investigation into alleged malpractice both by CPA officials handling the process and by the minister. Fuelling allegations of bribery was the fact that the licences went for a song, fetching only $5m in total.

Then the minister, backed by the CPA-appointed Governing Council, launched an investigation of his own, into an Iraqi-born British billionaire, Nadhmi Auchi, reportedly a shareholder in Orascom, a successful bidder based in Egypt. Mr Auchi, it was said, had been a business associate of Saddam Hussein and hence was unworthy to play a part in building a new Iraq. The minister asked fewer questions of a bid won by, among others, close friends of the Pentagon's favourite former exile, Ahmed Chalabi.

American and Turkish firms that lost the bidding have led the complaining and speculation about corruption. Still, when the two-year contracts are finally implemented, the winning Arab and Kurdish firms are likely to profit only modestly. The lion's share will go to two big equipment makers, Motorola and Siemens.

Meanwhile, the longer the politicians fight, the worse things get. A shipment of Motorola equipment bound for Orascom in Baghdad was ambushed on the road from Jordan. Staff have come under attack doing preliminary work for a licence that will require the firm to provide mobile coverage to Fallujah, the centre of the Iraqi insurgency. Delays will have cost Iraq and its occupying administrators dear, and are raising big questions about how well the huge amounts of money budgeted by America for other reconstruction projects will be spent. “If they can't even get this right,” asks one Iraqi businessman, “how can they administer $19 billion?”

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Mobile telecoms

Much ado about porting

Nov 27th 2003
From The Economist print edition

Why America's mobile-phone market is more like Australia's than Hong Kong's

MOBILE phones may be portable, but in America it is only this week that the same can be said of their numbers. On November 24th, wireless number portability—the ability to keep your mobile number when switching from one network operator to another—became a legal right in most of America. There has been much speculation about portability's likely impact. There were predictions that throngs of customers would switch operators. But this deluge has yet to materialise.

Much of the fuss was based on comparisons to Hong Kong, one of first countries to introduce portability, in March 1999. Churn rates—the proportion of subscribers who switch from one operator to another each month—soared. In three years, 5m subscribers switched operators and kept their numbers, in a territory with a population of 7m. The lesson for America's hyper-competitive mobile industry, it seemed, was clear: portability would be great for users but terrible for operators.

But the comparison to Hong Kong is invalid, says Marta Muñoz of Ovum, a telecoms consultancy. Hong Kong was a highly saturated market when portability came in, so churn was high anyway, since the only way operators could attract additional subscribers was to poach them. Portability added fuel to the fire.

America is relatively unsaturated. It is more like Australia, says Ms Muñoz, where portability arrived in September 2001. At the time, few Australian mobile subscribers had pre-paid subscription plans. Instead, most had one-year contracts, which are also common in America. This spread out the impact, as subscribers waited for their contracts to end before switching operators. That also seems likely in America, where many mobile phones are sold in the holiday season. Rather than pay up to $200 to escape contracts early, many would-be switchers will simply wait.

Besides, American customers have always been able to switch operators. “The option to port one's number is a bonus, rather than a reason to churn,” says Ms Muñoz. In most countries, churn rises briefly after the introduction of portability, then falls again. A new report by UBS, an investment bank, predicts that average monthly churn in America will rise from 2.4% in 2003 to 2.7% in 2004. The churn in the first quarter of 2001, however, reached 2.9%. So the impact of portabilitymay be hard to see amid seasonal variations.

What is unusual about America's implementation of portability is that customers will be able to transfer their fixed-line numbers to mobile phones. Already the incumbent fixed-line operators, the Baby Bells, are losing fixed-line subscriptions at a rate of 10m lines per year as customers give up their second lines in favour of broadband, cable and wireless connections, or switch to rival fixed-line operators. But again, the impact of portability may be small. UBS estimates that the Bells will lose an additional 0.7m fixed lines as customers transfer to wireless phones.

In short, portability will probably make little difference in a market as fiercely competitive as America's. Some operators will do marginally better and some marginally worse. There will no doubt be some good deals on offer during the holiday season, but, then again, there always are.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

The toy business

Grinched

Nov 27th 2003 | NEW YORK
From The Economist print edition

Even Santa might not help

NO ONE has bigger wishes for the holiday shopping season that kicks off this Thanksgiving weekend than America's beleaguered toy retailers. After years of poor results, many of the best-known names are reeling. FAO Schwarz, an American icon with a flagship store on New York's Fifth Avenue, teeters on the edge of bankruptcy. The debt of Toys “R” Us has just been downgraded to near junk status by Standard & Poor's, a rating agency.

A slow economy has hurt, but the real problems are that children have changed and toy distribution has changed more. Sales of toys by American manufacturers and importers have not grown in at least three years. Stuffed bears, dolls, trucks, building blocks and other traditional favourites have had a particularly tough time. When people do buy toys they often shun the large toy retailers and head for discounters, notably Wal-Mart, which now dominates much of American retailing and has just launched a price war in some of the most popular toys, such as this year's must-buy, Hokey Pokey Elmo.

The only parts of the business growing fast are computerised games and learning toys, which are often sold by specialist stores. A few firms have been able to straddle this evolution. One is LeapFrog, a start-up financed by Michael Milken, a former junk-bond financier and jailbird, and Larry Ellison, the boss of Oracle. This produces electronic devices with instructional programmes for children. In this, its second year as a public company, revenues may be nearly $700m, up by more than 25% from last year. Profits are rising almost as fast.

That is of little consolation to FAO Schwarz. For much of its 141-year history it was known for offering the world's best toys, regardless of price. Even now, it offers a $30,000 miniature car, a stuffed water buffalo for $4,500 and a doll with human hair for $2,500. The wealthy bought and the rest came to gawk, but often left with bags of smaller purchases. Numerous films have featured joyful moments at Schwarz, such as “Big”, in which a child in a man's body delights an old toy manufacturer by playing music with his feet on a piano keyboard laid out on the floor.

But the magic went a while back, along with the floor piano. Last year, Schwarz was bought by The Right Start, a troubled retailer of education toys. As part of a reorganisation, almost half of the outlets of the two firms were closed. Yet hopes that contraction alone could save the combined business were short lived. Schwarz recently announced that it received a default notice from its lenders, who were taking a hard line on advancing more money. Conceivably, a serious cash crisis could emerge, though the firm is probably safe for the next month at least. It is hard to imagine any creditor putting a toy retailer out of business in the weeks before Christmas, when the bulk of retail profits are earned. Surviving for another year, however, is another matter, and may require a miraculous gift from Santa.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Biotech in Cuba

Truly revolutionary

Nov 27th 2003 | HAVANA
From The Economist print edition

Cuba wants to profit from the biotechnology revolution

INTEREST in Cuba's unique brand of biotechnology has been growing since May 2002, when America's undersecretary of state, John Bolton, said that the island was developing “a limited offensive biological warfare” programme. The Cubans vehemently denied this. Whatever the truth of that claim, one thing is clear: Fidel Castro's scientists have been churning out an impressive line of genetically engineered products, from fast-growing fish to recombinant vaccines and cancer therapeutics.

Cuba has spent over 20 years and a reported $1 billion building up its biotech industry. Unfortunately, the industry has little to show for this effort in the way of sales or profits, largely because its marketing skills lag far behind its scientific prowess. This will not come as a shock to capitalists.

AP

Biotech investor

Biotechnology Havana, a big conference held in the Cuban capital this week, aimed to bring together scientists and businessmen as part of the country's renewed search for risk capital from abroad.

There remain huge political obstacles to developing the industry's commercial potential, not least the fact that Cuba is still a socialist dictatorship. Many foreign firms are understandably deterred by the prospect of meddling government bureaucrats. Many others are also put off by America's Helms-Burton act, which could shut them out of American markets for doing business in Cuba. Yet so-called “receptor companies”, such as Canada's YM BioSciences (YMB), which both develop and package Cuban products, have been busy agreeing joint-venture licences with some of Havana's leading biotech centres.

One of the most promising drugs promoted this week is a novel anti-cancer vaccine developed by YMB and Havana's Centre of Molecular Immunology. David Allan, boss of YMB, says that the drug is evidence of a Cuban ability to “think outside the box” in approaching cancer treatment.

A big goal of this week's meeting was to dispel the belief that Cuban biotech has prospered by developing knock-off versions of already patented drugs: a common complaint against the drugs industries of poorer countries. Cuban officials say their country enforces international protocols, such as the World Trade Organisation's Trade-Related Aspects of Intellectual Property Rights agreement. True, they admit, the Cuban state does own the intellectual property embodied in the products of the country's biotech research institutes. But this, they say, is little different to the institutional ownership of patents in America by bodies such as university regents. The result in both cases, they say, can be good, affordable drugs.

The United Nations has not been slow to jump on the bandwagon. In 2000, a World Health Organisation inspection approved Cuba's hepatitis B vaccine for use in the UN's vaccination campaign. Also included in Cuba's growing intellectual-property portfolio is the patent on a meningitis B vaccine, now undergoing further clinical trials with GlaxoSmithKline. Several other Canadian and European biotech firms have followed YMB's lead, licensing Cuban technology. Given the interest generated at Biotechnology Havana, many more such joint ventures may now be in the offing.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Deregulation in Japan

Tilting at windmills?

Nov 27th 2003 | TOKYO
From The Economist print edition

Don Quijote takes on Japan's all-powerful bureaucrats

CHAOTIC stores that sell TVs, Louis Vuitton handbags, bikes and much more have helped Don Quijote, a discount-retailer, to increase its profits for 13 years in a row. Its latest bid to overturn tradition has set it against Japan's mighty Ministry of Health, Labour and Welfare.

Painful-reality TV

The battle began in August when Don Quijote decided to sell non-prescription drugs all day—and all night. Though regulations bar stores from selling medicine without a pharmacist on the premises, the retailer installed videophones at ten stores so that customers wanting a night-time box of aspirin could do so after consulting a pharmacist remotely. Staff had been disheartened at having to explain to angry or suffering customers why they were unable to offer pain-relief during the few hours when a pharmacist was unavailable, says Sumio Inamura of Don Quijote.

Local health authorities quickly gave warning that the new service might be illegal. Don Quijote responded by offering instead free minimum doses of non-prescription drugs after-hours (and after a videophone consultation), saying that the regulations covered only sales of drugs. That was beside the point, retorted the health minister. Then, in October, the retailer tested a regulatory loophole. Sales of medicine by catalogue are allowed. So the firm set up an in-store catalogue service, enabling customers to order, pay for and pick up drugs at its shops.

The much-publicised clash has won Don Quijote the support of several prefectural governors, including Shintaro Ishihara, the governor of Tokyo, and the Regulatory Reform Council, a government body that promotes deregulation. It is also proving popular with customers. Meanwhile, the health ministry has set up an “independent” council to determine whether videophone sales are legal. A decision may be reached in December.

Don Quijote is one of only a few companies that have dared publicly to take on Japan's powerful ministries. Its battle is reminiscent of those fought by Yamato Transport, these days Japan's biggest parcel-delivery firm, which fought the transport ministry (in court) and the postal ministry (at the Fair Trade Commission) in its drive to create a door-to-door delivery market in the 1980s and 1990s (and is still trying to beat back Japan Post, a public entity which until recently was controlled by the postal ministry). MK Taxi, a Kyoto-based taxi firm, has also repeatedly fought the transport ministry during the past couple of decades, as it tries to create a cheaper, customer-friendly taxi service.

The three firms are similar in many ways. Don Quijote and MK Taxi are not big, and Yamato was also smaller (and on the verge of collapse) when it first fought with the transport ministry. Unlike their bigger brethren, they lacked the financial clout and bureaucratic connections created when retired mandarins “descend from heaven” into well-paying jobs in the private sector. Nor could these domestic service firms easily expand overseas, like some manufacturing start-ups which have gone on to be global leaders.

There has been some deregulation in Japan, thanks in part to the Regulatory Reform Council—set up by the government in 1995, but driven by its private-sector members—which reckons reforms had already boosted the economy by about ¥16 trillion ($142 billion) by 2001. Air fares have been liberalised and restrictions on self-service petrol stations lifted, for example.

On the other hand, partial reform of the post office in April won the mammoth institution more perks than it lost. Last month's deregulation of alcohol sales-licences came with a clause that exempted one-third of the country. Vested interests with bureaucratic and political connections remain powerful, even when consumers overwhelmingly support reform. Don Quijote faces opposition from unions representing pharmacists, while Yamato had to fight the powerful post office.

The Regulatory Reform Council wants even unlicensed shops to be able to stock non-prescription drugs, but faces an uphill battle. Japan's bureaucracies are territorial and have the discretion to interpret vague laws (and change their interpretations), which gives them huge power. The very fact that reforms that were once unmentionable are now being debated is a sign of progress, says Yasushi Nakayama, a director at the Regulatory Reform Council. Yet Don Quijote will surely be hoping that it has done more than simply tilt in vain at Japan's bureaucratic windmills.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Face value

India's turn-round queen

Nov 27th 2003
From The Economist print edition

Ranjana Kumar shows that you can succeed in India even if you are not in information technology

“NINE decades of trust,” boasts Indian Bank's slogan. Well, maybe eight. The proud state-owned institution, headquartered in Chennai (formerly Madras), slumped in the 1990s. In 1999, a “management advisory group”, appointed by India's central bank, noted that Indian Bank's “accumulated losses exceed its capital and reserves”. It was, in short, bust. The bank groaned under mountains of bad loans, many of them made for political or corrupt motives. Its workers were ageing, risk-averse and demoralised, their unions strong and change-resistant.

For all the recent excitement about India's fast-growing information-technology sector, much of the country's economy has remained mired in its bad old ways. Indian Bank suffered an acute case of a disease that afflicts many public-sector banks (which together control three-quarters of banking assets)—bad loans. These make up less than 10% of total bank lending in India's official figures, but may actually be double that, according to estimates published in June by Crisil, a private credit-rating agency. That is still far below levels seen in China, or in South-East Asia after its slump. But there are serious concerns about the ability of India's banking system to deliver credit efficiently to an economy expected to grow by at least 7% this year.

“The most crucial aspect” in turning Indian Bank around, concluded the advisory group, would be to find the right new boss. They lighted on Ranjana Kumar, who had been running another state-owned bank, Canara, after a long career at a third, Bank of India. She was the second new broom asked to clear up the mess at Indian Bank. Her predecessors, installed in 1995, had made things worse. Two measures in particular back-fired: a freeze on new credit, to stem the flood of bad lending; and the reference of several loans to India's criminal-prosecution and anti-corruption bodies. As a result, good borrowers were turned away, and the bank's loan portfolio continued to worsen. Staff, meanwhile, became gripped, in Mrs Kumar's words, by a “fear psychosis”. This was unfair, since “not everybody was a crook”.

Her remarkable success in bringing Indian Bank back into profit has turned her into an award-winning celebrity of the Indian finance scene, feted for her turn-round expertise. Among her many good qualities

are limitless energy, great persuasive power and, above all, common sense.

By 1999, 44% of the bank's loans were “non-performing”, a worse ratio than at any other Indian bank. Its lending rates were high, driving away yet more customers, and 18.5 billion rupees ($430m) of new government capital had been swallowed up. Its employees, whose ages averaged 47, were shy of taking risks and swiftly forgetting how to. Public-sector companies were prohibited from doing business with the bank because of its feeble balance sheet. For similar reasons, in 2001, Indian Bank was threatened by the local regulator with a humiliating expulsion from Singapore, one of its two overseas bases.

On taking the job in June 2000, Mrs Kumar negotiated with the government for yet another recapitalisation. This time, however, disbursement of the first slice was delayed for 22 months and made conditional on the bank's performance. On the strength of this, Mrs Kumar reached a written understanding with the unions about a three-year restructuring plan.

She then proceeded to simplify management structures, to merge 119 of more than 1,400 branches all over India and to shed 3,000 of the bank's 25,000 staff under voluntary redundancy schemes. No one was sacked. She also set about trying to get some of the bank's money back from its delinquent debtors. A “securitisation” act passed by India's Parliament last year was intended to make it easier for banks to foreclose and seize assets. Indian Bank, for example, has issued 700 notices under the act, and taken over 12 properties. But bankers say the impact of the legislation has so far been disappointing. As the law now stands, bizarrely, banks cannot sell assets without the borrower's permission. Its main impact has been psychological.

Mrs Kumar also went on an aggressive drive to attract new customers. To infuse a bit of youthful vigour into the bank, 300 freshly graduated MBAs are employed for three months in the summer. Several hundred younger staff have been recruited or promoted from clerical grades.

The recovery ward

These days, Indian Bank seems almost a picture of health. Non-performing assets are down to 12% of gross advances. Some 800,000 new customers have been added. In the six months ending in September, it turned an operating profit of 2.6 billion rupees. A stockmarket listing is planned by early 2005.

By then, Mrs Kumar will be well advanced in her next rescue mission, at the National Bank for Agricultural and Rural Development, a troubled government refinancing institution. She seems to enjoy the limelight. But not everybody thinks her undoubted talents were best deployed at Indian Bank. Perhaps she would have been better used turning around other parts of the economy. India's banking sector really needed a more radical solution. India has 27 state-owned banks offering similar products. Even Mrs Kumar acknowledges the need for consolidation. Moreover, banking competition is distorted by the government guarantee which even loss-making state banks enjoy. In 2001, for example, Indian Bank's average cost of deposits was only 7.5% per year, below that of most private banks.

In its 1999 report, the management advisory group pondered three options for Indian Bank: closure, merger and rehabilitation. But closure, it said, “for obvious reasons”, did not merit consideration. Nor, in its debilitated state, did merger with a healthier institution. That left the search for a saviour. Mrs Kumar turned out to be exactly the right candidate. But that does not mean rehabilitation was the right choice.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Internet security

Fighting the worms of mass destruction

Nov 27th 2003 | SAN FRANCISCO
From The Economist print edition

Hooligans are trashing our online space. How can they be stopped?

WHEN Microsoft released its latest monthly batch of software patches on November 11th, it included one designed to repair a previously unknown flaw in Windows 2000. Such an event often acts as a tip-off to the writers of computer worms and viruses, who know that new patches are never applied very widely or very quickly. It is possible that this new flaw could herald a series of computer failures at least as damaging as those seen earlier in the year.

Bill Gates, the chairman of Microsoft, once made a habit of using his keynote speech at Comdex, the computer industry's top annual trade show, to launch his company's "next big thing". Not all of these innovations succeeded, though at the time of their unveiling they all contained something to excite the industry. But times have changed. Mr Gates began his speech at the Las Vegas show this month by unveiling a dull bit of software that manages the distribution of security patches on a network. He followed this with an almost equally dreary firewall and a new spam-filtering initiative. These, rather than glitzy product announcements, are the industry's new priorities. Closing loopholes exploited by viruses, worms and hackers, said Mr Gates, is "the largest thing we are doing".

Eradicating spam is a top priority for the American government too. The Can Spam Act made comfortable progress through Congress this week, the first piece of federal legislation to attempt to reduce the amount of unsolicited electronic garbage passing over the internet. Opinion is divided as to how effective the new law will be. But if it works at all, it will also help to improve internet security. Spam is often the transmitter of computer viruses.

Cyber-louts

The biggest fear is that viruses and worms will be used by terrorists to hold societies to ransom. Last year, American spies found a shack in Pakistan where it appeared that al-Qaeda had been training hackers to break into the computer systems of dams, power grids and nuclear plants. Computer failures may have played a role in the vast power black-outs in north-eastern America and parts of Canada that occurred at the same time.

However, according to Bruce Schneier, a leading expert on network security, only one instance so far

deserves to be called cyber-terrorism. In 2000, a hacker named Vitek Boden broke into the computers of an Australian sewage plant and leaked raw effluent into rivers and parks, killing fish but no people. However, Mr Boden was no ordinary terrorist. Not only had he helped to design and install the system that he attacked, but even with his inside knowledge he had considerable difficulty breaking in.

Terrorists may try more sinister acts. Nonetheless, the internet is a surprisingly difficult medium for them. Malicious code has the potential to cause huge annoyance and disruption. But for people intent on carnage and terror, rather than disruption, blowing oneself up or similar low-tech methods remain far more attractive.

A better word for the threat of internet crime is therefore “cyber-hooliganism”, says Mr Schneier. Less than 1% of recent computer attacks originated in countries that America considers breeding grounds for terrorists; the vast majority came from inside America itself. Hackers are more likely to be geeky teens on an ego trip, or greedy crooks hoping to steal money online, than Islamic fundamentalists.

Gone phishing

The promise of the internet knows few bounds: economists think it can boost productivity, efficiency and prosperity much further; entrepreneurs are still excited by its facilitation of online commerce; and more and more consumers prefer it to shops. To realise its full potential, however, the net has to become more trustworthy.

Yet it is rapidly becoming less so. The Blaster worm and SoBig virus that attacked this summer caused estimated losses of $35 billion. Attacks are getting more frequent, as well as more insidious, relying less often on viruses (which require human action, such as double-clicking on an e-mail attachment) and more often on worms (which propagate by themselves through any unprotected connections on the network). This means that the threat can only grow as “always-on” broadband connections to the internet replace dial-up access, and as ever more devices in addition to PCs are connected.

Attacks are also happening faster. A few years ago, it typically took virus writers a year to exploit a software vulnerability announced by a vendor. This gap between disclosure of a flaw and attack has been shrinking. For the Slammer worm in January it was six months, and for Blaster in August a mere three weeks. It is almost three weeks now since Microsoft brought out its patch for Windows 2000.

Attacks are also more intense and brief. Slammer infected 90% of vulnerable computers within ten minutes. Future attacks, says Gerhard Eschelbeck, the technology boss of Qualys, a network-security monitoring firm, will do their damage within a couple of minutes. Qualys says that it takes organisations an average of one month to patch their known vulnerabilities.

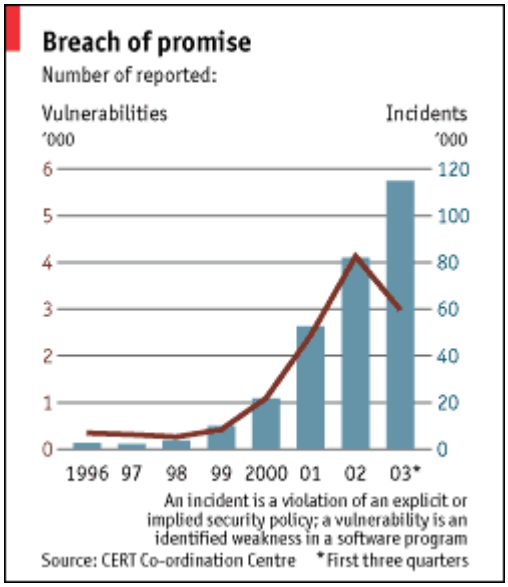
Viruses and worms, moreover, are only one form of internet crime. Brightmail, the world's market leader in filtering e-mails for fraud and spam, recently found that 10% of all e-mails were scams of one sort or another. Nigerian letters are probably notorious enough by now to be more comical than dangerous. But a lot of fraud is cunning. This includes brand spoofs—e-mails that pretend to come from famous and trusted consumer companies—fake web pages, phoney press releases, and “phishing”, which tricks recipients into giving out sensitive information, such as credit-card numbers.

The gizmos fight back

The resulting anxiety naturally suits vendors of protection technologies, whose sales have been rising sharply. Sometimes the vendors seem to be peddling fear, and it is working. Most companies and governments nowadays use firewalls (devices to keep malicious code out of their internal networks), intrusion-detection systems (which analyse what gets past the firewalls) and similar technologies. Consumers also increasingly have anti-virus software on their computers, though many of them fail to keep it up-to-date.

These gizmos work up to a point. Jerry Ungermann, the president of Check Point, the world's largest vendor of firewalls, boasts that none of his customers was affected by Blaster because Check Point was so quick to put the appropriate defences into its products. Rival vendors of anti-virus software often compete fiercely in their

marketing, but share information as soon as a new virus appears. VeriSign, a company that manages the domain-name systems for .com and .net, is evolving into a sort of CIA of the net, spotting suspicious traffic early and warning those at risk.



Protective “good” code, however, is not by itself enough to fight off incoming “evil” code. As with crime in the physical world, the efforts to fend off break-ins need the support and sanctions of the law. Lawrence Lessig, a professor at Stanford University and an expert on cyberlaw, says that when it comes to cyberspace, policymakers have so far shown themselves to be consistently “stupid and bribable”. How else, he asks, to explain the curious hierarchy of their current priorities. Online copyrights come at the top because of the powerful lobbying of music companies, which are better described as firms faced with a rapidly eroding business model than as victims of crime. Near the bottom comes the online privacy of millions of consumers.

Though more government action will undoubtedly be needed, caution is also in order when considering new laws against cybercrime, lest they make matters worse. This is especially important because most of the experts who advise the lawmakers are not disinterested parties. Qualys's Mr Eschelbeck, for instance, thinks Congress should pass a law requiring companies to subscribe to automated audits of their systems, which happens to be the service provided by Qualys.

All roads lead to Microsoft

The issue of commercial interests interfering with sound responses becomes especially acute when the debate turns to Microsoft, the world's largest software company. Ask, for instance, Dan Geer, an expert on software security and a top executive of @Stake, a security consulting firm. In September, he led a group that wrote a report blaming Microsoft's virtual “monoculture” in operating systems for the internet's frailty. No sooner was the report published than he found himself out of a job. @Stake, which counts Microsoft among its customers, “fired me by press release, retroactively and in public,” he says.

The gist of Mr Geer's argument is that Microsoft has over the years created “unacceptable levels of complexity” in its computer code. It has done so because its main objective has been to lock users into its software by tying the Windows operating system together with applications such as Word, Explorer and Outlook. Complexity is “the enemy of security”, says Mr Geer's report, since “the defender has to counter all possible attacks; the attacker only has to find one unblocked means of attack.” Moreover, complexity feeds on itself since “fixing a known flaw is likely to introduce a new, unknown flaw.”

On this analysis, many of today's problems stem from Microsoft's success in creating a virtual monopoly. Some 94% of PCs run on Windows. So nearly all the computers on the periphery of the internet, where the users are lay people rather than professional network-administrators, rely on the same software, which happens to be of Byzantine complexity. This practically invites hackers to attack these machines. A single good hit at Windows could take down the whole system.

Not surprisingly, Microsoft bristles at this line of thought. The only reason the firm has been bundling the operating system with applications is that customers want it to, says Mike Nash, a Microsoft executive in charge of security issues. He finds it “personally insulting that people think our motivation is anything else.”

Mr Nash also denies that Windows' code is less secure than other operating systems', such as Linux or Apple's Mac OSX. Scott Charney, another Microsoft executive, goes further and defends the monoculture. If one operating system is dominant, he says, companies can save costs by training IT staff only once, and security updates are easier since there is only one source of the patches that mend flaws.

But the patches often create more security problems than they fix, and there is a fear that Microsoft might use such regular access to desktops to keep rival software-makers away, thus reinforcing the source of the original problem, its monoculture. “If you don't trust us to download our patch, then you shouldn't be running our software,” counters Mr Charney, as if consumers had a real choice.

Nonetheless, even if Microsoft, with its disproportionate share of the market, constitutes a

disproportionate share of the problem, it is not clear what to do about it. Many of the arguments sound tediously reminiscent of the American government's prolonged antitrust case against the firm in the late 1990s. Even Mr Geer, for instance, is not advising that Microsoft be broken up. Instead, he wants Microsoft to make its applications run on any rival platform, and to publish the interface protocols that will allow rival applications to spring up and survive. This might lead to some biodiversity of code.

Mr Schneier, one of the authors of the report submitted by Mr Geer, proposes a more fundamental solution. Cybercrime, he argues, is “not a technological problem; it's an economic problem: the incentives aren't there for smart people to solve the problem.” The culprit, in other words, is the licences that require buyers of new software to click their assent that the vendor is not liable for any flaws in its software. As long as software vendors—and this is not specific to Microsoft—cannot be held liable for security issues, Mr Schneier says, the economic incentives are stacked toward adding bells and whistles and shipping upgrades fast, rather than toward writing simpler, safer software.

Changing the law so that liability does rest at least in part with vendors, he argues, would align the incentives properly and lead to other good things as well. Software companies, just like firms in other industries, would buy product-liability insurance. Insurance companies would respond by pricing the risk, in effect voting on the security of each product. Just as companies that install sprinklers in their warehouses pay lower premiums and have a competitive edge over rivals that do not, software companies that write safer code would have an economic advantage.

No responsibility without liability?

In what could become a precedent, the first lawsuit against Microsoft on product-liability grounds was filed in a court in Los Angeles in October, accusing the company of violating California's consumer-protection laws by selling shoddy software. Legally, the approach may be controversial. Suing Microsoft over a Windows virus is not quite analogous to suing, say, a carmaker for selling vehicles that tip over while being driven. In the first case, a third party, the hacker, is committing a crime by exploiting a weakness in the product; in the latter case, the product fails without outside criminal intervention. A better analogy may be suing a maker of bullet-proof vests whose products fail to protect their wearers against bullets.

Some argue that the cost of insuring against product liability might stifle software innovation. Not so, says Stanford's Mr Lessig. A small upstart company making a small operating system would not present much of a target to hackers, and would thus pay negligible premiums. In any case, even if caution did lead to a few programs not being written, says Mr Schneier, so what? America's Food and Drug Administration can be said to stifle innovation too in so far as it leads to the marketing of fewer but safer drugs. In software, the risks are now simply too great not to make a similar trade-off, he says.

Microsoft argues that the constant attacks against its software—4,000 so far against Windows, according to Symantec, an anti-virus company—are threatening its brand and business prospects even without litigation. The argument that without product liability companies won't pay attention to security “is just not true,” says Mr Charney. Microsoft has already pulled out all the stops, he argues, and is retraining its programmers, reviewing their code and changing its entire culture. Unfortunately, security has to be built into software from the beginning—patches are just what their name suggests.

First find the users and abusers

Concentrating entirely on the accountability of software vendors is like fighting burglary by leaning on the makers of alarm systems. A parallel approach to the problem of internet insecurity is, therefore, to focus on the internet's users, discouraging bad behaviour and ensuring that criminals can be traced. Legally, however, that could become as controversial as product liability. Mr Lessig suggests using a bounty system to catch hackers, which might involve enlisting those most able to catch them—namely, other hackers. “I'd bet my job that it works,” he says.

The issue boils down to the question of how much anonymity society can tolerate on the internet. Drivers' licences and registration plates dramatically reduce the incidence of hit-and-run accidents. Crack cocaine is never bought by credit card. If everybody on the internet were easily traceable, people would think twice about hacking. “I'm kind of a fan of eliminating anonymity,” says Alan Nugent, the chief technologist at Novell, a software company, “if that is the price for security.”

The internet is heading in this direction already. Enrique Salem, Brightmail's chief executive, says that all e-mail in future will either be authenticated or be sent into a quarantined in-box where few will dare to click. The sender's authentication may well be tied to a driving licence, social-security number or passport. An entire industry has sprung up to work on other forms of identification, such as the biometric scanning of irises or hands.

All this may not be pleasing to libertarians, who envisioned the internet as offering individuals the cover of relative obscurity. What use is the network to dissidents in China if the Communist Party is watching everything they do online? And what use is the internet, whose whole point was to connect people, if it is balkanised into separate, walled subnets?

The reality, however, is that the internet is already balkanised. Companies and governments have intranets, where users' privileges depend on their log-in. Virtual private networks (VPNs) traverse the public internet like guarded convoys. For example, employees at Merrill Lynch, an investment bank, cannot check their Hotmail or Yahoo! e-mail accounts while surfing the internet at work.

The proper analogy for what the internet might evolve into, says Novell's Mr Nugent, is a public library, a place where readers can browse in relative anonymity, but only until they take a book out, at which point they have to identify themselves. The degree of traceability varies with what one does in such a place.

To preserve freedom further, suggests Mr Lessig, anonymity could be replaced by pseudonymity. It might become legal, for instance, to have credit cards for online transactions under different names, as long as these could still be traced to the individual owner. The challenge is to set the legal hurdles for online search warrants high enough so that governments cannot abuse their power. But at the same time to keep them low enough so that criminals can be found and stopped. In this respect, the online world should be no different from the real one.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Investment banking

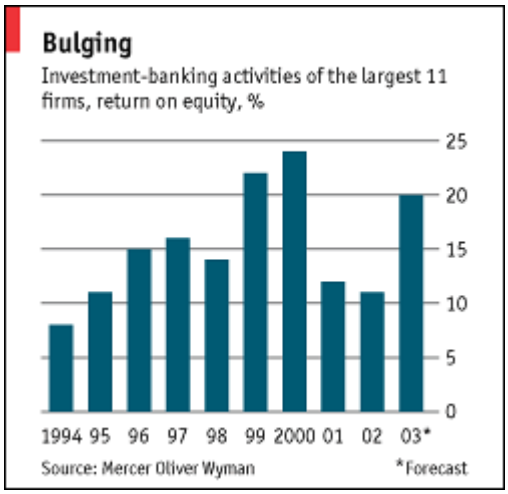
Sound and fury

Nov 27th 2003
From The Economist print edition

Signifying nothing: despite all the scandals of the past year, investment banks are making record profits

THE good folk at Morgan Stanley are a little chastened. Having trumpeted how clean it was earlier this year when Eliot Spitzer, New York state's energetic attorney-general, forced Wall Street to cough up $1.4 billion for issuing biased research, the starchiest investment bank of the lot must now pay $50m for mis-selling mutual funds. Even banks with the least tarnished reputations seem riddled with conflicts of interest, perverse incentives and greed.

Small wonder that they have bleated as regulators have shone a spotlight into their murkiest corners. Funnily enough, the extra attention does not seem to have hurt them much. Indeed, profits have held up remarkably well. The Securities Industry Association (SIA), a trade group, estimates that Wall Street firms will earn $22.5 billion this year, over three times what they made last year and more even than the $21 billion they made in 2000. This year, reckons Mercer Oliver Wyman, a consultancy, their return on equity will be around 20%, almost double last year's figure, and only slightly less than the peak of 24% in 2000 (see chart). In not one year since the bubble popped have the top, bulge-bracket firms as a group lost money. Investors who have spent the past few years fulminating at tumbling stockmarkets and Wall Street greed will doubtless be delighted.



Banks have been raking it in partly because of the bull market in bonds, which accompanied the bear market in equities. How much they will continue to earn from bonds is moot, though, now that interest rates seem to have hit bottom. They have also slashed bonuses (a big part of their wage bills) and staff numbers with equal ferocity, and are now reaping the benefits. In the late 1990s, Wall Street made Hollywood look a model of parsimony. Then, good analysts (ie, those that pulled in profits for investment bankers) earned millions. Banks have taken the opportunity to get rid of a lot of them now that their role has caused such a fuss, and a few

have cut their research departments to the point of invisibility. The number of people employed in the securities industry in New York, a reasonable guide to the savagery, has dropped by 41,000 from its peak, to 176,000, according to the SIA.

Revenues, moreover, did not drop as sharply as might have been supposed. They have subsequently picked up as equity markets have sputtered back to life. In 2003, thinks Mercer Oliver Wyman, global investment-banking revenues will be some $200 billion, about the same as in 2000—and more than double the level of ten years ago.

Investment banks have also been betting more of their shareholders' cash. Earlier this month Charles Prince, the newish chief executive of Citigroup, told investors that he wanted to increase the amount of proprietary trading by his bank. The degree to which banks are trading more on their own account can be gauged by the increase in capital devoted to risk-taking. “Value-at-Risk”, a number used by management and regulators to assess whether banks have enough capital to cover their risks, has risen for almost all. It has more than doubled at Goldman Sachs which, despite its blue-chip reputation, is now regarded on Wall Street as little more than a hedge fund with an investment-banking business attached.

In fact, proprietary trading has been rising for years. Banking bosses claimed to have eschewed it because investors disliked its volatile results and because they could get similar exposure more cheaply by investing in hedge funds. Sandy Weill, Mr Prince's predecessor, even closed Citi's proprietary-trading operations five years ago because he thought them too risky. However, he did invest the bank's money in the hedge fund that its traders set up. Often, however, proprietary trading has simply been renamed “customer flows”, which sounds better but is little different.

Why are all these banks returning to the risk-taking game? One reason, an open secret at banks, is that it flatters their cost-income ratios—a measure of banks' efficiency—because it requires so few people. Another is that banks have become better at it, even though many of their star traders left to set up hedge funds. Risk management has improved, which may be why banks were not caught out as badly by the carnage in the Treasury market earlier this year as they had been when bond prices last fell as sharply, in 1994.

For investment banks' shareholders, the third reason is perhaps the most worrying: margins on other businesses are falling as fast as volumes are climbing. In the past decade, says Mercer Oliver Wyman, volumes have grown by 15% a year on average, but revenues by only 7%. Margins on bond trading are nearly at zero. They are falling fast in equities and derivatives, and are even being dented in mergers and acquisitions and initial public offerings, for which banks typically sting issuers for 7% of the money raised.

Wiring with wisdom

Moreover, getting rid of analysts and other expensive people is only one way in which investment banks will need to save money. More difficult will be better use of technology. This was supposed to pose a threat to investment banks, which, after all, are little more than well-rewarded financial intermediaries, and yet also to provide a solution to some of their problems. Many tasks, such as back-office work, trading and sales, could be done more cheaply by machines than by people. Technology spending soared. Despite the recent cost-cutting, however, America's securities industry employs over a quarter of a million more people now than ten years ago.

Even the banks themselves admit they have invested poorly in technology. In the late 1990s, they duplicated traders and salesmen rather than replacing them. Worse, banks' chief investment officers have historically been cheerleaders for technology, not gatekeepers, and much of the spending was on must-have new kit for the whizz kids who make the money and are thus hard to refuse.

Banks are now trying to spend more wisely on technology, in part by moving information-technology jobs to places such as Bangalore. There, says one director at a big bank, programmers are “much cheaper, better qualified and more competent”. But wiser spending will require bankers to work more closely together, and that, in turn, will mean banks having to do something about their most intractable problem: incentives.

For all the bonus-cutting in frosty times, reining wages in is hard when markets warm up, because rival banks compete to lure away one another's star money-makers. The prospect of a lot of cash in a short time is sure to mean that bankers, even more than most workers, think far more about their own pay

than about the long-term health of the bank—or, for that matter, of their customers.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

The Executive Life affair

Come on, Jacques

Nov 27th 2003 | PARIS
From The Economist print edition

Can the French president continue to block a deal to end the scandal?

A DEADLINE is usually just that: cross it and consequences follow. Not, it seems, if you are French and involved in the case of Executive Life, a Californian insurance company that was bought illegally in 1991 by Crédit Lyonnais, then a state-owned bank. Last month, after the expiry of two earlier deadlines, American prosecutors told the French government that a settlement of criminal charges relating to the purchase of Executive Life must be agreed by November 24th.

AFP

Pensive Pinault

The explicit threat was that, failing a deal, indictments against Crédit Lyonnais and others would be unsealed, presaging a hugely embarrassing fraud trial. The deadline came and went without a deal. The indictments, however, remained sealed.

Instead the French announced that they had secured a new date for an agreement: December 1st. What on earth is going on? The Americans, normally tight-lipped, say that a deal has, in fact, been agreed with Crédit Lyonnais and CDR, a state-owned body created in 1995 to take on the bank's bad assets. Curiously, the terms are exactly as they were at the last deadline: the French are willing to pay $585m in criminal fines and cash to go towards an eventual settlement of a parallel civil case brought on behalf of California's insurance commission.

Both the bank and CDR are keen to close the affair. France's finance minister has no problems with the proffered deal. Not so Jacques Chirac, France's president. Late on November 25th, the French president simply refused to sign. The reason is that the proposed settlement still excludes François Pinault, one of France's richest businessmen and one of Mr Chirac's closest friends. Mr Pinault, whose company Artémis bought Executive Life and made fat profits, was behind the derailing of the settlement last month. After Mr Pinault lobbied Mr Chirac, France's justice minister said that his country wanted a “global” settlement, leaving “no one outside”.

The Americans have confirmed that no agreement has been reached with Mr Pinault. Lawyers close to the negotiations say that Mr Pinault wants to settle any liabilities associated with the scandal. But he is haggling over how much he must pay, arguing that he does not have enough cash to meet fines and restitution of maybe $185m being demanded. He has, however, reportedly managed to win an agreement that, if he does eventually settle, he will not have to plead guilty to a felony.

It is unclear why the American camp is risking its own credibility by playing along with what amounts to French political cronyism. One theory is that the prosecutors are prepared to wait in order to achieve what they think is a good deal. But this seems odd. Unsealing indictments would demonstrate seriousness of intent without precluding a settlement later.

Also excluded from the proposed settlement is Jean Peyrelevade, former chairman of Crédit Lyonnais. He resigned last month after prosecutors found evidence suggesting that, contrary to testimony he had previously made, he had known all along about the illegal scheme used to buy Executive Life. However, as *The Economist* went to press Mr Peyrelevade was refusing to plead guilty and pay a fine.

That raises the possibility of a deal without him if Mr Pinault can agree terms. If that happens next week, then the French justice minister would have to eat his words. The so-called global deal would, in fact, be a special arrangement designed to benefit Mr Pinault. Just like the original Executive Life deal, really.

An investigation by *The Economist* into the roles of Mr Pinault and Crédit Lyonnais in the Executive Life affair can be read here

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Takeovers in Europe

Lowest common denominator

Nov 27th 2003
From The Economist print edition

Too much compromise over the EU's draft takeover directive

FRITS BOLKESTEIN, the commissioner in charge of the European Union's single market, wanted to go for the nuclear option. His proposals for making it easier to take over companies in the European Union had been so watered down that, on November 26th, the Dutchman tried to talk his fellow commissioners into vetoing them altogether. They refused, because most preferred a poor compromise to nothing at all. From them, it passed to the EU's industry ministers and to the European Parliament's legal-affairs committee. To Mr Bolkestein's chagrin, both groups voted to approve the compromise on November 27th.

Mr Bolkestein, an economic liberaliser, would like to make takeovers in the EU much easier. He thinks that cross-border mergers and acquisitions would help restructure European industry and make the EU's economy more competitive. He also believes takeovers can be jump-started only by new EU-wide rules.

After a previous draft directive was rejected by the European Parliament in 2001, Mr Bolkestein produced a new text, adopted by the commission in October 2002. He recommended that companies be obliged to ask shareholders' permission for anti-takeover measures, such as the pre-emptive sale of parts of a company or the issuing of new shares to friendly parties. He proposed a ban on multiple voting-rights that give holders of small stakes disproportionate influence. He also suggested a “breakthrough” rule to nullify defensive actions against a bidder who has accumulated 75% of a firm's shares.

In the past year Germany, Sweden and other countries have lobbied furiously to weaken Mr Bolkestein's proposal. The French sided quickly with the Germans. Germany bought British support by helping to block a separate proposal to extend the rights of temporary workers. Swedes talked other small countries into supporting them. This campaign paid off: the draft's main measures have become optional, and thus pointless in Mr Bolkestein's eyes.

What motivates Mr Bolkestein's opponents? The Germans fear losing control of Volkswagen, which is protected from takeover by a special law. Having seen Mannesmann, a telecoms firm, bought by Britain's Vodafone in 2000, they worry that other firms might fall into foreign hands. Chris Huhne, a member of the European Parliament, says it seems paradoxical for a country so keen on political integration to stand in the way of unifying Europe's capital markets; but German trade unions fear for their country's social model and boards worry that foreign owners might put an end to their cosy corporate governance. The Swedes think that the abolition of multiple voting-rights would make their corporate empires vulnerable. The Wallenberg family, for instance, owns only 7% of Ericsson, a telecoms firm, yet controls the company, with an ally, because one class of shares carries 1,000 times the voting rights of another class.

Approved by ministers and the legal committee, the draft directive will be submitted to the full parliament next month. After 14 years of negotiation, its chances of passing the last hurdle are good. Mr Bolkestein, however, would have preferred something with teeth.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

German Landesbanks

Deep impact

Nov 27th 2003 | FRANKFURT
From The Economist print edition

A revealing dispute over credit ratings

A CARTOON doing the rounds in London dealing rooms shows two dinosaurs, bearing the names of German Landesbanks, watching a meteorite hit the earth. “No problem,” says one. “Standard & Poor's has given us a year to evolve.”

Standard & Poor's (S&P), a rating agency, this week gave the 11 Landesbanks—public-sector entities that are local development banks, house banks for state governments and clearers for local savings banks—a short reprieve. Under political pressure, S&P has postponed until July its plans to publish ratings that reflect the Landesbanks' creditworthiness without state guarantees, which they are due to lose progressively after July 2005.

Fact and fiction
Ratings of Landesbanks' long-term debt

	Current S&P rating	Unguaranteed rating*
Bayerische Landesbank	AAA	BBB+
HSH Nordbank	AA-	A
Landesbank Baden-Württemberg	AAA	A+
Landesbank Hessen-Thüringen	AA+	A
Landesbank Rheinland-Pfalz	AA+	BBB
Landesbank Sachsen	AA	BBB
WestLB	AA	BBB

*Unofficial ratings based on indications by S&P, Fitch and market sources
Source: Credit-rating agencies and market sources

Delay does not alter the facts. The state guarantees mean that the Landesbanks enjoy generous ratings, some as high as AAA. Without this backing, at least three would drop to BBB, too low for the refinancing needs of a wholesale bank (see table). Protests at S&P's plans by the public-sector banks' associations, the Bundesbank, and BaFin, Germany's financial regulator, merely drew attention to opinion that has been in the market for years.

Two other rating agencies, Moody's and Fitch, already publish “financial strength” and “individual” ratings for the banks. Most are near the bottom of a scale from A to E. A credit-default swap—insurance against default or restructuring of debt—is relatively dear for Landesbank debt, even with the state guarantee. It costs 25-30 basis points (hundredths of a percentage point) a year to insure against default by WestLB, the largest Landesbank. This is about ten points more than for most big banks. In October, when the bank had boardroom trouble, the price soared to 65 points. J.P. Morgan already makes a market in the risk of default after 2005, when debt without guarantees will start to be issued. The price there is 50 to 60 points.

The biggest concern, for both credit analysts and traders, is that Landesbanks will have trouble refinancing themselves after 2005. Take the second biggest, Bayerische Landesbank. One-third of its €340 billion ($400 billion) balance sheet is funded either by short-term borrowing from other banks or by short-term commercial paper. The cost of this debt—indeed, the bank's ability to raise it at all—will be affected by its credit rating. Under proposed new international rules, due to come in at the end of 2006, the amount of capital that banks will have to set aside to cover loans to other banks will depend on the borrowers' credit ratings. A BBB rating would virtually shut a bank out of the interbank market.

The outlook is not quite that grim. Most Landesbanks will still enjoy the implicit support of their public-sector owners after 2005. Fitch, taking that into account, predicts ratings of around A, with a couple of exceptions.

Some Landesbanks have restructured themselves in order to prepare for 2005, notably Landesbank Baden-Württemberg and HSH Nordbank. HSH Nordbank already has an unguaranteed perpetual bond with a decent rating from Moody's. Landesbank Hessen-Thüringen has recently allied itself with local savings banks in a capital-support pact. But WestLB, Landesbank Berlin, Landesbank Rheinland-Pfalz and Bayerische Landesbank all have uncertain futures and lack clear business strategies. This would be punished mercilessly by the credit markets if the banks had to stand on their own feet tomorrow. Time to

evolve, fast.

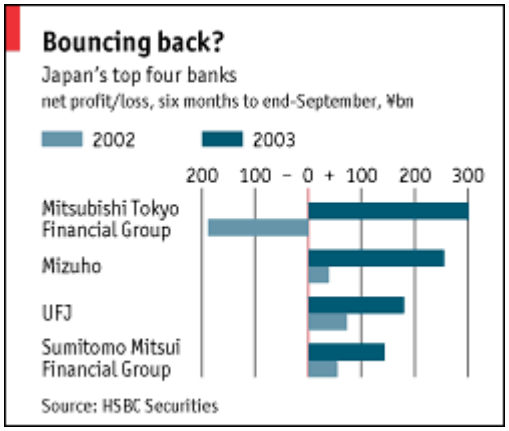
Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Japanese banks

Skin deep

Nov 27th 2003 | TOKYO
From The Economist print edition

Reasons why Japan's banks are not as healthy as their results suggest



HALF-YEAR figures published on November 25th indicate that Japan's big banks are on the road to recovery. Resona, the fifth largest, was an exception. It still managed to lose ¥1.8 trillion ($15.3 billion) in the six months to September 30th, despite being given ¥2 trillion of public money in May. But the country's four biggest banks all reported a sharp rise in net profit (see chart).

However, the banks' prospects are not as rosy as the results suggest. For starters, much of the improvement in profits will not be easy to sustain. Rising markets helped banks, which recorded unrealised gains in equity portfolios and large profits from bond trading in the spring. Further such gains may prove elusive. A windfall tax rebate also boosted profits. Another popular practice was to cut general reserves against bad loans, on the assumption that the economy is getting stronger, and record the write-backs as profits. Whether the banks will be able to repeat this trick remains to be seen.

Profitability in the banks' core businesses did not improve much: lending margins barely grew. Meanwhile, the volume of lending has fallen. According to the Bank of Japan, bank lending in October was 4.7% lower than a year before. Over the past five years, outstanding loans have shrunk by more than a fifth. Banks remain reluctant to take on more risk by making fresh loans: borrowers, especially small and medium-sized companies, are still wary of increasing their debt.

Falling bad-loan write-offs also seem to indicate that the worst of the banks' woes are over. Other data appear to back this up: according to Teikoku Databank, a research company, there were 19% fewer bankruptcies in October than a year before, the tenth consecutive month of year-on-year declines. Yet the number of latent bankruptcies is growing steadily beneath the surface, says Takakazu Nakamori of Teikoku Databank. Many small and medium-sized companies are being propped up by government loan guarantees and other financial help. Banks are also bailing out their worst borrowers by forgiving debt—while setting up fresh credit lines for them—or by taking equity in lieu of repayment. Such arrangements might well turn sour over the next year or so.

Nor has the quality of the banks' capital improved. Despite talk of reform from Heizo Takenaka, the financial-affairs minister, banks were again allowed to count large chunks of “deferred tax assets” as capital. These are created when a bank makes losses, and can be set against tax bills if the bank makes enough taxable profit in the next five years. They make up 44% of the tier-one capital of Mizuho, Japan's biggest bank, and half that of Sumitomo Mitsui Financial Group, the second biggest, and of UFS, number four. Subtract these and public funds that banks have promised to repay, say policy wonks in the opposition Democratic Party, and the top seven banks' average capital-adequacy ratio drops from 10.4% to 1.1%, far below the 8% that international rules require.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Entertainment finance

Star-struck

Nov 27th 2003
From The Economist print edition

Share in your idols' success

NEXT month Japanese investors will be able to buy into the careers of five would-be stars. The five—all female and attractive—were chosen from thousands by a firm named Japan Digital Content. It is launching a "talent fund" in which it will sell shares: ultimately, returns will depend on sales of DVDs, calendars and other paraphernalia.

The idea is not entirely new. In 1997 bankers issued bonds backed by future sales of music by David Bowie, a British singer. In exchange for the temporary music rights to 25 of his albums, Mr Bowie received $55m. Investors got an 8% yield on bonds rated at investment grade. Offerings by other top acts soon followed. David Pullman, the financier who pioneered Bowie bonds, has since issued securities backed by royalties from John Steinbeck's literary estate and from cartoon libraries.

However, equity financing of untested projects is a novelty. The Japanese pop hopefuls are not alone. In mid-November, "Billy Dead", a film to star and be produced by Ethan Hawke, an American actor, became the first movie to issue shares, which will be tradable. Civilian Capital, an online investment bank working with Mr Hawke, is on track to close the $7.9m issue in the next three months, says its president, Barry Poltermann. Filming is due to start in 2004. Investors will have first call on all profits until their money is returned, and then a percentage of earnings—from box-office sales, sequels and merchandise.

DigiCirc, another Californian firm, is also raising money from public investors, this time for music. Investors can buy or lease the rights to songs or albums posted on DigiCirc's website by unknown musicians in return for a piece of future profits.

Is a glamorous new asset-class in the making? Not yet. Moody's, a rating agency, is considering downgrading Bowie bonds. Sales of Mr Bowie's CDs have been soggy, partly because of online piracy; and EMI, the music company that guaranteed the bonds, was itself downgraded by Moody's in March. Indeed, such securitisations have not become as fashionable as many expected. Few musicians own all of the rights to their music; fewer still can convince investors that their popularity will last.

Equity investments in unknown talent are even riskier. Sean Kane of Hall Dickler, a New York law firm, thinks that issuing securities backed by pools of intellectual property—from actors, authors and musicians—might solve this problem. Until then, fans-cum-investors may boost their idols' careers and incomes; but they might not be making the cleverest of investments.

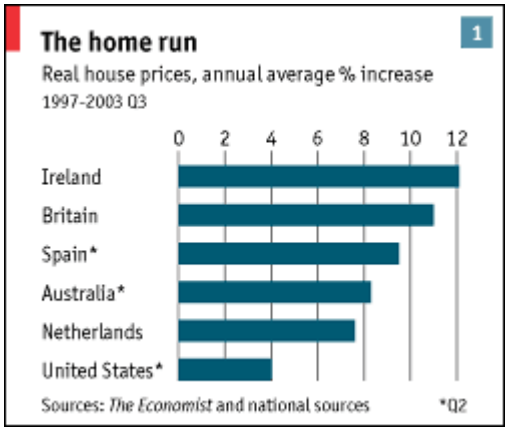
Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Property prices

Shaky foundations

Nov 27th 2003
From The Economist print edition

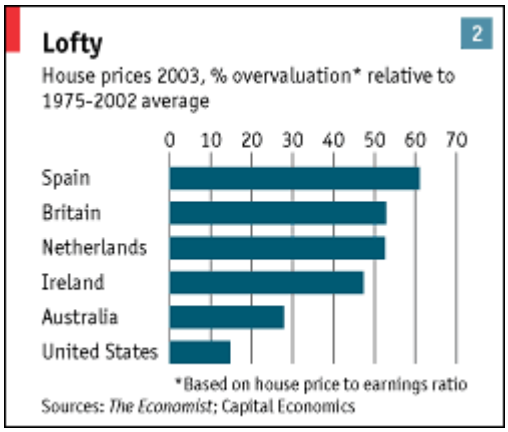
The higher house prices climb, the more they are likely to fall



"THERE is more chance of finding Elvis on the moon than there is of a house-price crash next year." John Wriglesworth, an economist at Hometrack, a British property-data firm, recently summed up the mood of housing experts not just in Britain but in many other countries as well. House prices' continued climb—despite a stockmarket crash, a global economic slowdown and a war—has strengthened confidence that they can only keep rising.

Since *The Economist* launched its global house-price indicators early last year, we have drawn attention to rapid rises in house prices in several countries. In the past five years, real house prices have increased at average annual rates of 8-12% in Australia, Britain, Ireland, the Netherlands and Spain (see chart 1). In comparison, America's 4% average annual gain may seem modest. Yet this is America's biggest real increase since records began. It also conceals bigger increases in many cities. In San Francisco and Boston real prices have risen by 10% a year.

In all six economies the ratio of house prices to average earnings is at record levels, much higher than its average level during 1975-2002 (see chart 2). In other words, these markets look distinctly bubbly. House prices continue to rise, except in the Netherlands, where they have recently levelled off.



Rapid price rises are not by themselves proof of a bubble. Robert Shiller, an economist at Yale University (and one of the few Americans to have seen the stockmarket bubble for what it was) reckons that the best test of a bubble is whether home purchases are motivated by expectations of future price increases: ie, buyers view a home not merely as a roof over their head, but as an easy way to make money.

Mr Shiller and Karl Case of Wellesley College have conducted a survey* this year of home buyers in four American cities: San Francisco, Los Angeles and Boston, where prices have surged in recent years; and Milwaukee, where price increases have been modest, as a control against which to compare the others. The vast majority of buyers said the expectation that prices would rise was a prime consideration in their purchase of a house. When they were asked how much they expected house prices to rise over the next ten years, the startling answer was an annual average of 13-16% in Los Angeles, San Francisco and Boston. The authors conclude that house prices in these cities look bubbly.

In other countries, too, many people bruised by losses in the stockmarket or who no longer trust their pension schemes to support them in retirement have come to view housing as the best investment. In Australia thousands have flocked to property-investment seminars promising "get rich quick" schemes. According to a survey by Mintel, a market-research firm, 39% of Britons think that investing in bricks and mortar is now the best way to save for old age, by either buying-to-let or purchasing a bigger home and trading down when they retire. Only 27% favour company pensions.

Looking at the past ten years' returns, this may seem wise. But over longer periods pension funds

(mainly invested in shares) have outperformed property. According to Sabina Kalyan of Capital Economics, a research company, over the past 70 years British equities have yielded a real annual post-tax return of 4.5%, while investment in housing (for rental) has incurred a loss of 3.7%.

Worse, the sums behind buying-to-let look increasingly dodgy. While house prices have soared, rents have been fairly flat or have even fallen. In America, Britain and Spain the average net rental yield after maintenance and letting costs has dropped to 3-4%. This is less than mortgage rates, so many landlords are not covering their costs. No problem, retort many: we will make our profit from capital gains. This sounds ominously like an echo of the dotcom bubble, when it was argued that the old link between share prices and profits no longer mattered.

The hottest buy-to-let market is in Australia, where investors now account for 40% of all new mortgages. As the supply of property to let has risen, rents have tumbled. Shane Oliver, an economist at AMP Henderson in Sydney, calculates that net rental yields are now only about 1%. There are already signs that the market is reaching its limit: this week a leading property-investment seminar business, run by one Henry Kaye, collapsed. Australians paid an average of A$15,000 ($11,000) to attend Mr Kaye's sessions, which he claimed would turn them into millionaires.

When rates rise...

Even owner-occupiers may be uncomfortable if interest rates rise. Although a return to the double-digit mortgage rates of the late 1980s and early 1990s looks unlikely, debt is today much higher, in relation to income, than it was then, so small changes in interest rates will have a bigger impact on household budgets.

Despite low interest rates, households' mortgage payments (including debt repayment) are already close to record highs as a percentage of disposable income in America and Australia. So even a small rise in interest rates could quickly cause some pain. Simon Rubinsohn of Gerrard, a fund-management firm, estimates that in Britain mortgage payments currently amount to 12% of household income. If interest rates rise to 5%, as the market expects, this figure will rise to 14%. A rate of 6.5% would take the mortgage burden back to its 1990 peak of 15.5%. First-time buyers are already being squeezed out of the British market: the average deposit required of a first-timer has risen from 28% of annual income in 1997 to 80% this year.

House prices look unsustainable in Australia, Britain, Ireland, the Netherlands, Spain and large parts of America. But the existence of a bubble does not mean that a crash is imminent; prices could rise yet further, or they could deflate slowly. Still, one thing seems sure: given current valuations, those betting on further big gains in house prices will be disappointed. As for Elvis, he has been spotted house-hunting in London. Clearly a strong signal to sell.

---

* “Is there a Bubble in the Housing Market? An Analysis”: www.brookings.edu/es/commentary/journals/bpea_macro/forum/papers.htm

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economics focus

Stop worrying and love the deficit

Nov 27th 2003
From The Economist print edition

America's current-account deficit poses few dangers, says Alan Greenspan. Except to Europeans

IN THE past year the United States has run up a current-account deficit of more than $500 billion. Some think that the line of credit extended by the rest of the world to America is dangerously long. As Kenneth Rogoff, formerly chief economist of the International Monetary Fund, puts it, foreign creditors give poor countries “just enough rope to hang themselves”, but they are giving the Americans “enough rope to tie the noose around their neck several times.” Most countries with a deficit of such size would find the downward pressure on their currencies and the upward pressure on bond yields irresistible. They would be forced to cut their expenditure and switch their spending from imports to domestic production.

But for America the gallows do not beckon yet, according to a recent speech* by Alan Greenspan, the chairman of the Federal Reserve, at a conference sponsored by *The Economist* and the Cato Institute. Admittedly, Americans' demands on the world's savings are greater than ever. But Mr Greenspan argues that, thanks to spreading globalisation, the pool of savings on offer in today's global capital markets is deeper and more liquid than ever. The markets continue to furnish America with the money it needs without demanding higher yields in return.

In a recent paper† Michael Dooley, of the University of California at Santa Cruz, and David Folkerts-Landau and Peter Garber, of Deutsche Bank, come to the same sanguine conclusion from opposite premises: the deficit is manageable not because today's world is unique but because it replicates the post-war Bretton Woods era. America is once again at the centre of an international monetary system. On the periphery, where post-war Europe once stood, now stands East Asia, with its cosseted capital markets and fear of floating against the dollar. The players have changed, but the rules of the game are much the same.

Under Bretton Woods, the Europeans, as they regained their exporting strength, amassed ever greater dollar claims on America. Similarly, under today's “revived” Bretton Woods system, the East Asians hoard their export earnings in low-yielding dollar assets, such as Treasury bills. What East Asia hoards, America happily spends: the inflow of Asian capital keeps American interest rates low and demand high. Moreover, America tends to spend its cheap East Asian loans on cheap East Asian goods. America and Europe used to enjoy a similar relationship. As Jacques Rueff, a French economist, put it in 1965: “If I had an agreement with my tailor that whatever money I pay him returns to me the very same day as a loan, I would have no objection at all to ordering more suits from him.”

America gets more suits, but what do the East Asian tailors get out of it? Yields on safe, dollar assets are low and the opportunity cost is high, given better returns at home or elsewhere. Messrs Dooley, Folkerts-Landau and Garber argue that East Asia's governments are accumulating dollar assets as a by-product of a strategy of export-led growth. East Asia is prepared to forgo better returns in order to keep its exchange rates down and export demand up. This allows the region's industries to compete on world markets and attract foreign investment. To stretch Mr Rogoff's metaphor, the rope East Asia extends to America is not a noose but a tow-line, which will gradually pull Asian economies towards greater prosperity.

Others, such as Ronald McKinnon of Stanford University, think that American profligacy has trapped East Asia into running current-account surpluses. The region is forced to acquire dollar assets in order to avoid exchange-rate appreciation and deflation. Under the original Bretton Woods system, Mr McKinnon points out, America borrowed on a short-term basis from Europe, but lent long, making enormous direct

investments in the rebuilding of Europe's war-blasted capital stock. These days America (direct investments in China notwithstanding) borrows short in order to spend.

Slow change, or slower

The $500 billion question, however, is whether America's deficit is sustainable. The authors believe that the current system can endure, but that it will change. East Asia will continue to lend to America until the surplus labour in its hinterlands is absorbed into its export industries, its financial system has matured and its currencies are ready to float. And after East Asia has graduated from the economic periphery, as Europe did before it, South Asia may take its place. Mr Greenspan, by contrast, thinks America's build-up of foreign debt must slow and eventually be reversed. But he is confident of a soft landing: market forces will “incrementally defuse” the deficit. The dollar may fall and bond yields rise, but America is flexible enough to adjust painlessly.

Messrs Dooley, Folkerts-Landau and Garber put their faith in the rigged exchange rates and regulated capital markets of Asia. Mr Greenspan puts his faith in market forces and the flexibility of America. None of them thinks America should lose any sleep over its current-account deficit. All of them caution against protectionism, of which there have recently been unnerving signs.

Most of the discomfort caused by America's deficit will be felt neither in Asia nor in America but in Europe. European investors may be growing less willing to underwrite American borrowing for miserable returns: according to Morgan Stanley, they sold $403m-worth of American stocks, bonds and notes in September after purchasing $28 billion-worth a month between January and August. Meanwhile, European exporters are losing markets, squeezed out by an appreciating euro. However much rope East Asia provides, European necks are in the noose.

---

* www.federalreserve.gov/boarddocs/speeches/2003/20031120/default.htm

† “An Essay on the Revived Bretton Woods System”. NBER Working Paper no. 9971, September 2003: www.nber.org/papers/w9971

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Correction: foreign-currency scam

Nov 27th 2003
From The Economist print edition

In last week's issue ("Yet another crooked market") we said that an alleged perpetrator of a foreign-currency scam had claimed to have a contact at a Federal Reserve bank. In fact, this claim was made by a government agent working under cover.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

AIDS

A mixed prognosis

Nov 27th 2003
From The Economist print edition

AP

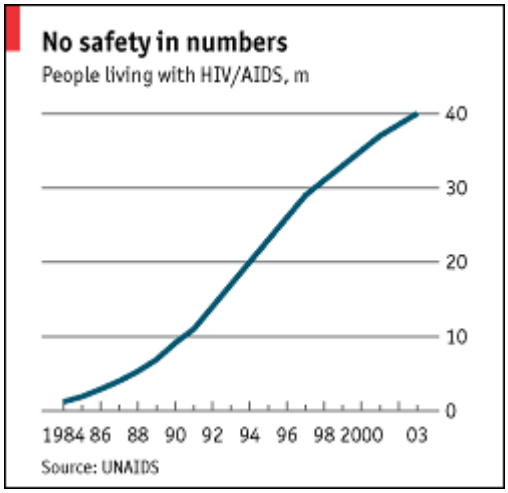
For all this week's sobering statistics, the global fight against AIDS is steadily gaining strength

Get article background

IN THE modern world, 20 years seems a long time to be at war, but it is hardly surprising when the enemy is as elusive, and pervasive, as HIV—the virus that causes the disease AIDS. It is two decades since scientists first identified the cause of what was a baffling new syndrome ravaging immune systems and destroying lives. Since then, AIDS has gone from being the scourge of relatively small groups, such as homosexuals and intravenous-drug users in rich countries, to arguably the biggest threat to life and prosperity in the developing world.

Although the epidemic continues to tear across Africa, Asia and Latin America, there is much optimism among policymakers and public-health experts that the battle against the disease has reached a turning point. Anti-AIDS programmes are growing larger and more coherent. And there is a growing political commitment to ensure that more money is spent and, crucially, new methods are exploited, in getting AIDS drugs to poor people.

Hope might seem odd in the face of this week's grim accounting from UNAIDS—the United Nations agency monitoring the disease. In its annual report on the epidemic, it estimates that a shocking 40m people are infected with HIV—2.5m of them are children. In 2003 alone, 5m were newly infected. Although the total number of people living with the virus seems to have grown more slowly in recent years (see chart), Peter Piot, head of UNAIDS, cautions against complacency. This apparent levelling off of the figures is largely the result of a steady rise in the AIDS death rate, from just over 2m in 1999 to 3m this year.



Means, motive, opportunity

Despite such dreadful figures, Stephen Lewis, Kofi Annan's special

envoy for AIDS in Africa, says he is more optimistic than he has been for years. Firstly, political leaders, especially in sub-Saharan Africa, are no longer as silent or apathetic as they were in the 1990s. Many are avidly, and publicly, discussing how to build up their national health-care systems to deal with AIDS. Much of this planning has yet to translate into action, though. And significant issues need to be addressed, such as the stigma that prevents people from getting tested or unfair inheritance laws that leave widows vulnerable. Nevertheless, public acknowledgment of the size of the problem and the need to act are important steps in the right direction.

The second reason for optimism is that there is now more money available. UNAIDS says about $4.7 billion was spent on AIDS in low and middle-income countries this year, compared with just $200m in 1996. The American Congress looks set to approve $2.4 billion to be spent next year, largely in the 14 countries that stand to benefit from the Bush administration's five-year plan to fight AIDS in Africa and the Caribbean. The multilateral Global Fund to Fight AIDS, Tuberculosis and Malaria, which was founded last year, has already committed $2.1 billion to projects in more than 120 countries.

And yet much more will be needed, both from wealthy donors and the governments of poor countries. Another $4.1 billion is needed by 2005 merely to honour and extend the Global Fund's commitments for example. UNAIDS says the world needs a total of $10 billion a year by 2005 just to keep AIDS in check.

The biggest change in the past year is a significant boost to the prospect of providing anti-HIV medicines. At the moment, only 800,000 people take the cocktail of drugs needed to keep HIV under control. More than three-fifths of these patients are in rich countries. Most of the rest are in Latin America. Poor people have gone without drugs because they have been too expensive, and the countries where they live lack the staff and medical systems to deliver the appropriate medications.

These factors are now changing. Since 2000, the cost of the drug cocktail needed to treat AIDS has fallen from $10,000 per patient annually to $300. This is largely thanks to competition from generic medicines, produced by firms such as Cipla, a drugmaker in India. Innovative drug firms holding patents on these medicines have also cut their prices for poor countries. Prices will also fall further thanks to a new deal brokered by the Clinton Foundation, a charity established by the eponymous former President Bill. Four Indian drugmakers will produce anti-retroviral medicines for roughly $140 per patient annually—courtesy of production efficiencies worked out between the foundation and the drugmakers.

There have been other moves this year to expand access to drugs. In August, members of the World Trade Organisation (WTO) agreed on compulsory licensing, so that countries without the capacity to make their own drugs could import generic versions from countries whose domestic patent laws might prohibit this. Canada is now planning to change its laws to allow its home-grown companies to supply this market.

This week also saw the launch of Cumvivium, a new charity set up by the International Federation of Catholic Pharmacists with the blessing of the Vatican. The federation aims to help poor countries to obtain two-dozen types of low-cost pharmaceuticals, and hopes to receive funds from the European Union for this. It has signed agreements with over 60 drug firms, and wants to start pilot schemes in two countries early next year.

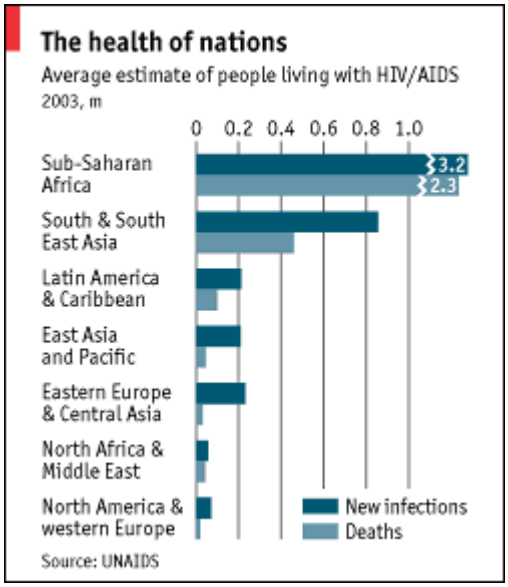
In addition, the South African and Chinese governments announced this month that they would provide anti-retroviral drugs to everyone who needs them. This is a huge step forward for countries that have spent years downplaying their AIDS crises. South Africa's programme is particularly bold. Mr Piot calls it “historic”. It will cost about $680m a year by 2007 to buy drugs, set up clinics and train thousands of health workers.

This flurry of activity will receive a further encouragement when, on December 1st, WHO launches “3 by 5”—a plan to get 3m people on anti-retroviral treatment by the end of 2005. If this is achieved, it will represent a ten-fold increase in the number of people in poor countries taking anti-retrovirals.

The WHO also hopes to use its negotiating clout to help poor countries procure good drugs cheaply, and its expertise to create the health-care systems to deliver them. This will involve training volunteers, rather than just qualified medical personnel, to deliver simplified drug regimens and to monitor their effects, in remote parts. Rather than waiting for a complex laboratory assessment

before starting treatment, as would happen in richer places, patients will be prescribed drugs straight away. This is controversial, but groups such as Médecins Sans Frontières, a big aid organisation, have shown that it can work. Dr Kim is unapologetic: “If they wait to do things as we do in the West, then it will take too long and there will be many more deaths.”

Money for the initiative may well come largely from the Global Fund. Richard Feachem, its head, reckons the programme will cost roughly $3 billion a year for the next two years. And WHO is busy forming emergency-response teams to help countries participate in the scheme. Already 20 countries have applied to join. The scheme will require careful monitoring but Dr Kim says it will prolong the lives of millions of people. It will also have the useful side-effect of establishing health-care systems that can deliver long-term therapies. These, in turn, should prove useful in coping with future chronic diseases, such as diabetes. Offering people therapy could also encourage them to seek testing and counselling. As more people find out that they are HIV positive, the stigma surrounding the disease should hopefully diminish.



Orphans of the storm

If the world is, at last, trying to muster an adequate medical response to AIDS in poor places, the same cannot be said about the vast socio-economic implications of the epidemic. It is hard to fathom, let alone fix, a situation in which most teachers and farmers are expected to die of AIDS, as in Botswana.

Arguably the epidemic's cruellest legacy, though, is the orphans it is leaving behind. Around 11m children in sub-Saharan Africa have lost at least one parent to AIDS. This is 11 times the number in 1990. The situation is about to get a lot worse, according to a report published this week by UNICEF. By 2010, there could be as many as 20m AIDS orphans in sub-Saharan Africa. Even if widespread anti-retroviral treatment takes hold, some think it will, at best, spare only 1.8m children from such a loss.

If not for AIDS, the number of orphans worldwide would have been tumbling. As it is, roughly one-in-ten sub-Saharan children is now an orphan. A third of these are the result of AIDS. Orphaning rates above 5% worry UNICEF because they exceed the capacity of local communities to care for parentless children. So how do places such as Zambia, where almost 12% of children are AIDS orphans, cope?

Not well enough, says UNICEF. More than half the countries south of the Sahara have no national plans to care for AIDS orphans. Most African orphans are taken in by their extended families which have, in the past, masked the problem by dispersing it. These households, though, are often headed by frail grandparents struggling to cope with these extra dependants.

Orphans tend to be poorer than non-orphans, and to face a higher risk of malnutrition, stunting and death—even if they are free of HIV themselves. They also endure the psychological trauma of watching parents waste away, and often have to watch as their subsequent care-givers suffer the same fate. Many are also separated from their siblings. Small wonder that a recent study of more than 350 AIDS orphans in Congo found that nearly 40% were suffering from post-traumatic stress, and a third were depressed, anxious or irritable.

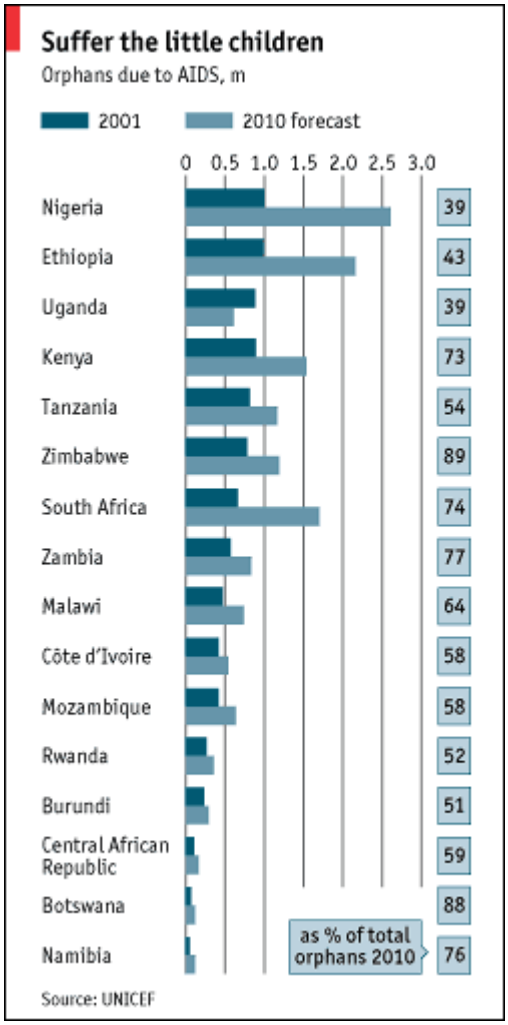
Their future prospects, too, are grim. Orphans are less likely to attend school—partly because they cannot afford the fees but also because step-parents tend to educate their own children first. Many drift on to the streets, as the teeming slums of Nairobi and Lusaka attest. Many go to work. In Zambia, for example, more than two-thirds of the child prostitutes are AIDS orphans. As a result, these children are themselves at high risk of HIV infection.

As Mr Lewis points out, the orphan problem could have dire long-term effects. Today's AIDS orphans, he says, are having children of their own. As they have never learned parenting skills from their own mothers or fathers, they may find it hard to be parents themselves.

Some church groups and other NGOs are trying to break this awful cycle. In Malawi, for example, Save the Children is supporting a programme that tries to help orphans in their own families. This is better than institutionalising the children, an option that is also more expensive.

In Uganda, another international NGO called Plan is helping families to come to terms with an impending death. This includes training guardians and helping soon-to-be-bereaved children to prepare “memory books” so that they will have a record of their parents.

Some governments have made moves to tackle the orphan crisis. In Uganda and Kenya, free primary-school education is allowing millions more children–including AIDS orphans—to get an education. Uganda has been so successful in curbing its epidemic that the number of AIDS orphans should start to decline by 2010. No other sub-Saharan country can expect such a blessing. One preliminary estimate from Columbia University puts the cost of tackling Africa's orphan problem at $4 billion annually. But as AIDS spreads elsewhere in the world, so too does the orphan problem, in countries as far afield as Haiti and India.



While there is welcome progress across many fronts in Africa, much more needs to be done. The same is true of other regions where the disease is now taking hold—among them eastern Europe, India and China. Indeed, the lessons learned and mistakes made in Africa should prove useful elsewhere. But it will take years before the impact of these new, large-scale initiatives are felt. AIDS itself is hard enough to beat; its broader social effects defy any quick fix.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

AIDS and the Middle East

Lifting the veil

Nov 27th 2003
From The Economist print edition

A new report says that Arab countries need to do more on AIDS

Get article background

WHILE HIV has a stranglehold on much of the developing world, most of the Middle East and North Africa seems to have escaped its deadly grip so far. According to UNAIDS—the United Nations agency monitoring the epidemic—there are between 470,000 and 730,000 HIV-infected people in the region. This seems to be a far cry from the situation south of the Sahara, where the average prevalence rate is more than 25 times higher.

But that could be a comforting delusion. David Robalino, co-author of a new report* on AIDS in the Middle East from the World Bank, says that official figures for the region may be too low as few governments are doing the right sort of surveillance.

AIDS is a tricky issue to measure, let alone tackle, in the Middle East. Many of the practices that contribute to its spread—homosexuality, intravenous drug use, and commercial sex—are either illegal or socially scorned. In many quarters there is a sense that AIDS is not a problem for the region because the teachings and practices of Islam, such as its strictures against extra-marital sex or its insistence on circumcision, confer some sort of cultural immunity.

This is clearly not the case. There have been recent outbreaks of HIV among intravenous-drug users in Libya and Iran. In Egypt about 1% of homosexuals surveyed carry the virus. And a study in Yemen has shown a 7% prevalence rate in a small sample of arrested sex workers. There are also large numbers of migrant workers and refugees who are particularly vulnerable to infection. Oussama Tawil, with UNAIDS in Cairo, worries that a veiled epidemic could take shape in high-risk groups that could one day spill over into the general population—as it did in Indonesia.

Aside from the tragic loss of human life this would represent, it could also have dire financial consequences as the disease takes its toll on labour productivity, savings rates and health-care spending. Mr Robalino says that by 2025 HIV could cost the region lost economic output equivalent to 35% of current GDP if steps such as use of safe needles and condoms are not promoted.

A few governments are rising to the challenge. Iran is trying to reduce infections among drug users. And Morocco has prevention programmes for sex workers and homosexuals, laws to protect the identity of patients and is one of the countries in the region to distribute anti-retroviral drugs to everyone who needs them. Moroccan charities also support AIDS patients.

Such a combination of political commitment, activity by charities and legal protection is rare in the region. As the sorry experience of India and South Africa shows, the sooner countries take action, the better.

* "HIV/AIDS in the Middle East and North Africa: The Costs of Inaction", by Carol Jenkins and David Robalino. World Bank. 2003.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

American political history

A paean for Roosevelt

Nov 27th 2003
From The Economist print edition

FDR's objectives may have been benign, but his techniques were ruthless

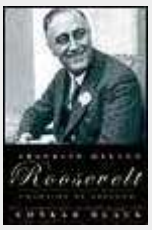
CONRAD BLACK'S life of Franklin Roosevelt is a great achievement, and all the more welcome for being more than a little surprising. Given the recent troubles within Lord Black's Hollinger business empire, one wonders how he found the time to write so long and so knowledgeable a book. Given his anti-European views, expressed so vehemently by his London newspapers, the *Daily Telegraph* and the *Sunday Telegraph*, one is brought up sharp by the steady fairness of this reassessment of a man whom he calls "the most important person of the 20th century".

To be sure, Lord Black does occasionally reveal his personal biases. There are gratuitous sarcasms about liberals, though fewer than a reader of his papers might expect. Lord Black is severe on what he calls the strategic "British flimflam of milling endlessly about in the Mediterranean". He seems not to like British civil servants. But these are captious criticisms. The book is well-researched, readable and judicious. It deserves to become the standard one-volume life of FDR, if a weighty one.

Lord Black is fair, not only to Roosevelt, but to most of those people who helped or hindered his career. He acknowledges the greatness of Winston Churchill, though he argues, justly, that after 1942 the prime minister "gradually marginalised himself through his Mediterranean strategy". He is even fair to Charles de Gaulle, and sees Roosevelt's treatment of him as one of the serious failings of his wartime conduct.

He is not blind to Roosevelt's faults. His objectives were almost always benign, he judges, "but his techniques, while bloodless, were not always much less ruthless, devious and cynical than Hitler's or Stalin's." Roosevelt "was a less admirable character, perhaps...than his admirers have traditionally believed. But in applying his ruthless and often amoral political genius to almost wholly desirable ends, he was a greater statesman than even his greatest supporters have appreciated."

Franklin Delano Roosevelt: Champion of Freedom
By Conrad Black



PublicAffairs; 1280 pages; $39.95.
Weidenfeld & Nicolson; £30

Buy it at
Amazon.com
Amazon.co.uk

Lord Black makes seven claims, which are not only just in themselves, but which illustrate the historical grasp and literary precision of this admirable book. First, that Roosevelt, together with Churchill, saved western civilisation, even though the speed of the victory owed something to the fighting qualities of the Russians. Then, that Roosevelt anchored America as a power in the world, patiently but in the end decisively, ending isolationism.

Third, he “reinvented the American state”, in the process restoring the confidence of Americans in their country and government “as an active promoter of an equitable society”. He was “an almost uniformly successful war leader”, more than can be said of Hitler or Stalin or Churchill. He also created the circumstances that enabled his post-war successors to complete the allied victory in the second world war. Lord Black wholeheartedly debunks what he calls the “Yalta myth”, claiming that, however ill and tired he may have been, Roosevelt was not bamboozled by Stalin, but merely recognised the realities of Soviet power at the time. Last, that all this was made possible by his “unmatched mastery of the American political system”, electoral, congressional and—though his methods were sometimes infuriatingly secretive—administrative.

Lord Black puts FDR in the company of Washington and Lincoln alone among his predecessors. Arguably, though he does not say so, Roosevelt may also have made it impossible for any of his successors, even men of the capability of Lyndon Johnson and Ronald Reagan, to live with the standard he set. His life seems almost miraculous; he contracted polio in 1921, after which he walked only with help and then with the greatest difficulty.

Perhaps Lord Black's greatest achievement is to show how in the process Franklin Roosevelt left behind him the residue of a spoiled upbringing and tempered his own steely character. The heat of that forge destroyed his children and many of those who worked for him. Only his wife, Eleanor, a cousin and as tough a character in her way as FDR himself, survived emotionally, though she was not unscarred. After his death, their daughter Anna had to explain to her mother that he had been, at the last, back in the company of his mistress Lucy Rutherfurd, whom Eleanor thought she had banished more than 25 years before. Such is the private life of those who have to live with Atlas as he holds up the burden of the world.

Franklin Delano Roosevelt: Champion of Freedom.
By Conrad Black.
PublicAffairs; 1280 pages; $39.95.
Weidenfeld & Nicolson; £30

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The war in Iraq

An elusive peace

Nov 27th 2003
From The Economist print edition

WITH the war in Iraq still raging, officially or not, a reader might be forgiven for casting a suspicious eye on the plethora of books that have already appeared on the subject. It can be some time before perspective and objectivity are possible: Michael Herr's seminal “Dispatches”, for example, was not published until three years after the end of the Vietnam war. So it is a pleasant surprise to find that good books on this war exist already.

Williamson Murray and Robert Scales, both American military academics, have produced a superlative record of the invasion—part history, part critique and part doctrinal template for the future. Technical and operational aspects are explained clearly without losing the depth required to make this a serious study.

“The Iraq War” draws on the lessons of past American adventures, from the limitations of technology demonstrated in Vietnam, to the successful use of “special forces” in Afghanistan. There is criticism for past American failings, such as the botched efforts to restore order in Panama after the 1989 invasion and the timidity of military and political leaders in dealing with the savagery in Rwanda and the former Yugoslavia. But such admissions add credibility to the authors' debate on the Iraq conflict.

They offer a potted history of the rise of the Baath party, but most of their focus is on the mechanics of the military invasion and its operational successes and failures. The coalition's military victory over at times solid resistance by the regime is attributed to the use of “overmatching power”, speed and flexibility. British forces receive praise for their ability to operate effectively with limited resources and for obtaining critical intelligence from special forces, Iraqi agents and other sources. The responsibility for Iraqi defeat is heaped entirely on the Baath leadership, for having a military machine designed more for internal suppression than for repelling invaders.

The conclusion is that, although the war is far from over, henceforth the Iraqis “will be influenced less by demonstrations of fighting strength than by the emotional security that comes from safe streets, employment, electricity and fresh water.” If the daily needs of Iraqis are not met, “political and military defeats will come later, and at greater cost.”

Reuters

Still learning

Anne Garrels, an American radio reporter, provides fascinating observations on the Iraqi population in “Naked in Baghdad”. She tours Baghdad before the invasion, frequently eluding her minders, to document conversations with Iraqis. An elderly barber who once trimmed the beard of King Faisal tells of oil wealth before Iraq's war with Iran. A murderer let out under Saddam's sweeping amnesty wonders aloud why he is released when political prisoners are not. A doctor complains of the

The Iraq War: A Military History
By Williamson Murray and Major-General Robert H. Scales junior

Harvard University Press; 312 pages; $25.95 and £16.95

Buy it at
Amazon.com
Amazon.co.uk

Naked in Baghdad: The Iraq War as Seen by NPR's Correspondent
By Anne Garrels

Farrar, Straus and Giroux; 222 pages; $22

Buy it at
Amazon.com
Amazon.co.uk

lack of medicines, the fault of both the government and sanctions. Corruption is endemic: by the time the war begins Ms Garrels is paying $1,000 for a $38 visa. Intelligence agents wander through the Al-Rashid hotel while Uday Hussein's bored Russian prostitutes dance in the garden.

While she loathes the regime and its apparatchiks, Ms Garrels admits to ambivalent feelings about the invasion. Her uncertainty is shared by many in Baghdad, who fear occupation will result in civil war and the partition of Iraq. There is widespread criticism for the reluctance of American forces to establish order. A marine officer tells Ms Garrels, “We're not policemen”; an army soldier puts it more bluntly, “I'm a trigger puller.” Iraqis are incensed that the oil ministry is rapidly secured while looters are allowed to ransack the national museum.

Ultimately, “The Iraq War” and “Naked in Baghdad” reach the same conclusion: that for all its might in war the United States has a great deal to learn about peace. If America squanders this opportunity to create a democracy in the Middle East and allows the formation of yet another hostile Islamic state, it will have virtually no one but itself to blame.

The Iraq War: A Military History.
By Williamson Murray and Major-General Robert H. Scales junior.
Harvard University Press; 312 pages; $25.95 and £16.95

Naked in Baghdad: The Iraq War as Seen by NPR's Correspondent.
By Anne Garrels.
Farrar, Straus and Giroux; 222 pages; $22

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Chiang Kai-shek

A Chinese enigma

Nov 27th 2003
From The Economist print edition

IT WOULD be easy to write off Chiang Kai-shek as one of history's greatest losers—a man who fought his way to the top of a heap of appalling warlords, only to surrender half of China to the Japanese in 1937-38 and the rest to the Communists a decade later. Easy, and more or less accurate. But this excellent biography by Jonathan Fenby, a former correspondent for this newspaper, does sterling service in its reminder of the dreadful constraints under which Chiang operated, and of his successes as well as his failures.

Generalissimo: Chiang Kai-shek and the China He Lost
By Jonathan Fenby

Free Press; 592 pages; £25.

Buy it at
Amazon.com
Amazon.co.uk

Among the successes there is the period known as the Nanking Republic, from 1927 to 1937, when Chiang ruled most of China (apart from Manchuria) in relative peace. Though far from being a democracy, and corrupt as well as austerely authoritarian, it was probably better than anything else China endured in the 20th century.

Perhaps the only flaw in the book is that it does not really attempt to reach a judgment about whether Chiang could have done more to oppose the Japanese. Mr Fenby appears inclined to accept Chiang's own view, that in the absence of any support from the morally bankrupt League of Nations, there was not much to be done about the Japanese. But it is surely worth examining the proposition that, had he not squandered his substance on fighting the Communists so assiduously in the 1920s and 1930s, he might have put up more of a fight against Japan after the Mukden incident in 1931. Five years later, when Chiang was kidnapped by his own side, demanding that he team up with the Communists against the Japanese, it was already too late. It was said at the time that the Japanese were a flesh wound, while communism was a disease of the heart. But had Japan not been able to seize eastern China so easily, the shape of the 20th century could have been very different.

Mr Fenby's account gives full range to an amazing cast of grotesques, such as the Shanghai drug barons, Pockmarked Huang and Big-Eared Du. Amazingly, Chiang placed Du in charge of his opium suppression bureaus. He gleefully describes the eccentricities of various warlords, among them the Christian General, the Model Governor, the drug-addict (and kidnapper) known as the Young Marshal, and the Dogmeat General, who gave his concubines numbers instead of names because they were easier to remember and who was said to have a penis as long as a stack of 86 silver dollars.

But Mr Fenby's best vignettes are reserved for Chiang himself—a syphilitic who dumped his second wife to make way for his well-connected but extraordinarily imperious third, Meiling Soong, who died only last month at the age of 105. Madame Chiang, too, is portrayed with all her warts, though she had her sympathisers. “It can't be easy to live with the crabbed little bastard and see everything balled up,” wrote General “Vinegar” Joe Stilwell, the man sent by the Americans to help Chiang. History is full of unanswerable what-ifs, but in the case of Chiang, there is a certain amount of evidence on which to base an assessment of what China would have been like under his rule. Taiwan in the 1950s, 1960s and early 1970s was joyless and repressed, though economically successful. It was over a decade after Chiang died that opposition was permitted and the largely bogus state of emergency lifted: only very recently has the monolithic Kuomintang crumbled, and the economy has not suffered. The merit of this highly readable book is that it harbours no illusions about the man who called himself the Generalissimo, but who his exasperated allies called the Peanut.

Generalissimo: Chiang Kai-shek and the China He Lost.
By Jonathan Fenby.
Free Press; 592 pages; £25.

To be published in America as "Chiang Kai-shek: China's Generalissimo and the Nation He Lost" by Carroll & Graf in January 2004

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Literary biography I

Simply Yeats

Nov 27th 2003
From The Economist print edition

THE Anglo-Irish poet W.B. Yeats throws up considerable challenges to any would-be biographer. Yeats was one of the four great, mould-breaking, English-language poets of the 20th century (the others, since you ask, were T.S. Eliot, Wallace Stevens and W.H. Auden). Since Yeats's death in 1939 his life has been memorialised by many serious biographers and many lesser commentators and reminiscence-merchants.

For all the weight of competition from those who knew Yeats a lot, a little and all points between, Roy Foster's two-volume biography (of which this is the concluding part) is a model of the serious literary life. It is learned and scholarly, but the book never fails to carry its learning lightly. It is astonishingly detailed, more so than any other Yeats biography, but the details never clog or slow down the narrative.

W.B.Yeats: A Life (Volume II, The Arch-Poet)
By R.F.Foster

Oxford University Press; 798 pages; $45 and £30

Buy it at
Amazon.com
Amazon.co.uk

Biographers of poets often find themselves bedevilled by the problem of relating the poems to the life. Not so Mr Foster. Although he quotes extensively from the poems, his comments seldom do more than offer us deft pointers towards an interpretation. In short, he lets the reader think for himself. And his manner of presentation has a good humoured sureness of touch throughout; this is no dry-as-dust final reckoning.

The life itself is as absorbing as its telling. Mr Foster takes up the story in 1915. Yeats is 50 years old, already famous as a poet of the Celtic twilight. From this point on, thanks, in part, to his professional relationship with the American poet Ezra Pound, Yeats begins to transform himself into a thoroughly modern 20th-century poet. He also becomes a controversial actor on the stage of Irish politics: during the turbulent 1920s, a period wracked by civil war, Yeats served as a senator of the Irish Free State.

Yeats was much preoccupied, from first to last, by the occult, and these engagements have often been an open invitation to obscurantists to do their worst: to prove in fact that they can write as obscurely about Yeats's relation to the occult as Yeats did himself. Mr Foster, once again, manages to be both clear- headed and quietly sensible by explaining often mumbo-jumboish things in plain language.

An interesting question which needs to be asked of biographers is this: do they love or hate their subject? It has often been the case that biographers, over those long years of selfless worship at the altar of another, have learnt to hate those who obsess them. Think of Lawrence Thompson's multi-volume biography of Robert Frost or (a particularly nasty recent example) Roger Lewis's vicious and silly life of Anthony Burgess.

Mr Foster, thank goodness, seems to have emerged from his long encounter with Yeats with a fairly equable and balanced view of this masterly poet. He is never slow to point out that Yeats had many faults—among them, pomposity, snobbery, reactionary attitudes of various kinds—and he is never slow to acknowledge his genius either; the way in which the best of the poet's work seems, almost effortlessly, to transcend the tissue of bewildering contradictions that was the man.

W.B.Yeats: A Life (Volume II, The Arch-Poet).
By R.F.Foster.
Oxford University Press; 798 pages; $45 and £30

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

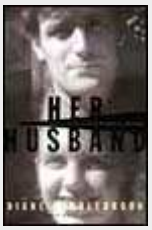
Literary biography II

Writings on a marriage

Nov 27th 2003
From The Economist print edition

SINCE her death in 1963, Sylvia Plath, an American poet, has had no difficulty attracting biographers. Why, one wonders, do we need another version of this well-worn story, which was recently retold on film with Gwyneth Paltrow as Sylvia? It is not as if Plath herself has been insufficiently documented. In fact, the more mysterious figure in the drama is her husband and fellow-poet, Ted Hughes, whose infidelity catapulted her towards suicide, and who, according to this new book, spent the next 30-odd years of his life haunted by his dead wife.

Her Husband: Hughes and Plath—Portrait of a Marriage
By Diane Middlebrook



Viking; 384 pages; $25.95

Buy it at
Amazon.com
Amazon.co.uk

Diane Middlebrook, who 12 years ago wrote a psychological biography of the confessional poet Anne Sexton, is well qualified to take on Mr and Mrs Hughes. But what is intriguing about her approach to the marriage is that she gives equal weight to both partners, tracing the way in which they used their poetry as a form of private dialogue.

Their relationship was always highly literary, starting with their legendary first encounter at a student party in Cambridge, where Plath bit Hughes hard on the cheek, drawing blood. Ms Middlebrook gives this melodramatic incident a context, fleshing out the Lawrentian background against which both young poets were self-consciously constructing their identities. Particularly welcome is the clarity with which Ms Middlebrook treats the poetic influences on Hughes, especially Robert Graves's “White Goddess”, with its quasi-anthropological, primitivist rhetoric. Hughes's interest in the human animal stripped of culture derived, ironically, as much from his highbrow reading as from his early experiences hunting and shooting on the Yorkshire moors.

Hughes's driving idea may have been predatory, but as a lover he appears oddly passive, more seduced by than seducing the women in his life. Having read his poetry, Plath must have known that a bite on the cheek would appeal to his belief in animal passion. In a strange parallel, Assia Wevill, the woman who broke up their marriage, hooked him by claiming she had had a dream about a pike—an image calculated to appeal to his imagination.

Rather than siding with the feminist fanatics who have claimed that Hughes in effect murdered Plath, Ms Middlebrook treads a measured path in her interpretation of the marriage, stressing the ways in which it fostered poetic creativity in both partners.

It is after Plath's death that the portrait of Hughes becomes less satisfying. One wants to know more about the personalities of the various women who attempted to take the place of their dead rival. The psychology of Wevill, who eventually outdid Plath in killing the four-year-old daughter she had with Hughes as well as herself, remains comparatively uncharted territory. Carol Orchard, who was Hughes's wife for the last 28 years of his life, remains a cipher. Yet although this book leaves some questions unanswered, it nevertheless offers a thought-provoking and often moving account.

Her Husband: Hughes and Plath—Portrait of a Marriage.
By Diane Middlebrook.
Viking; 384 pages; $25.95

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Eurojazz

Curiosity road

Nov 27th 2003
From The Economist print edition

A Swedish trio is putting new heart into an old idiom

ALTHOUGH jazz is indisputably American, it has excited Europeans almost from its beginnings. In fact, some continental connoisseurs seemed aware of the music's unique qualities sooner than its transatlantic begetters: the first attempt to incorporate the jazz idiom into classical music was not George Gershwin's famous “Rhapsody in Blue” of 1924, but “La Création du Monde”, premiered by Darius Milhaud, a Frenchman, a year earlier.

Much of the pioneering critical appreciation of jazz came from Europe, and American jazz musicians often sojourned or even settled there, delighted to experience star status instead of the racism which blighted their art and life back home. All the same, American jazzmen have felt a difference in the European view of jazz from the way it is perceived on its native ground.

For all their enthusiasm, many Old World fans seemed more attracted by manner than substance, yearning to cultivate what one British jazzer called “that swaggering Yankee buzz”. To the general European public, jazz was a lifestyle, a call to populist freedom subverting the ideological prejudices of high culture. And when it came to playing jazz, Europeans were bound to lack the basic elements which informed the music—the subtle inflections of blues and swing which came from its African-American roots and which could be merely mimicked elsewhere. As a leading French clarinettist put it, “We never really learned jazz over here in France. All I could do was imagine it.”

Recently however, European musicians have begun to feel more confident of their own abilities, and to see jazz as more than an exclusively American language, one in which their own traditions and experiences can play a creative part. Rather than trying simply to imitate the African-American idiom, they base their improvisations on different models. In the words of a French drummer, “We are all inspired by American musicians, but our background and our freedom and our way of living should influence the music and we should let go.”

Indeed, many European critics and musicians feel that their version of jazz has as much validity as the native product—or even more, since jazz in America has become dominated by what some observers feel is an unhealthy and uncreative concern with its historic traditions, which saps its real source of strength, a vigorous and imaginative response to the present. Europe's lack of an “authentic” connection to the roots of jazz may become a positive strength, a chance to revitalise the music from a variety of new sources. One group frequently singled out for attention and praise is a Swedish band, e.s.t.

Originally known as the Esbjorn Svensson Trio, after its pianist, it now conceives itself as a wholly corporate enterprise. Its latest CD, “Seven Days of Falling” (ACT 9012-2), encapsulates many of the aspects of a particularly European approach—a meditative atmosphere compounded of modal harmonies, a repeated rhythmic pulse, and long melodies which generate dramatic intensity. Lovers of blues and swing may feel that its hypnotic grooves have more to do with rock than jazz, but the trio's musicianship and technique are impeccable and the overall effect compelling. Typically, it recently starred at the London Jazz Festival, a supremely undogmatic event featuring musicians from all over the world.

Questions of musical categories do not concern e.s.t. over much. It is equally at home in rock venues and jazz clubs, and its records have crossed over to the pop charts. Depending on his mood, Mr Svensson regards the trio's work as a sign that European jazz has come of age, and is even challenging the native product in creative supremacy—“Europe is going to be the place for jazz”—or dismisses the connection altogether: “We're playing less and less jazz. It's more the e.s.t. sound...We just try to go to the heart.” Whichever lens he looks through, the group's ideals remain communication and curiosity, which seems a promising ground for European jazz, whatever its ultimate aesthetic links to its American ancestor.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

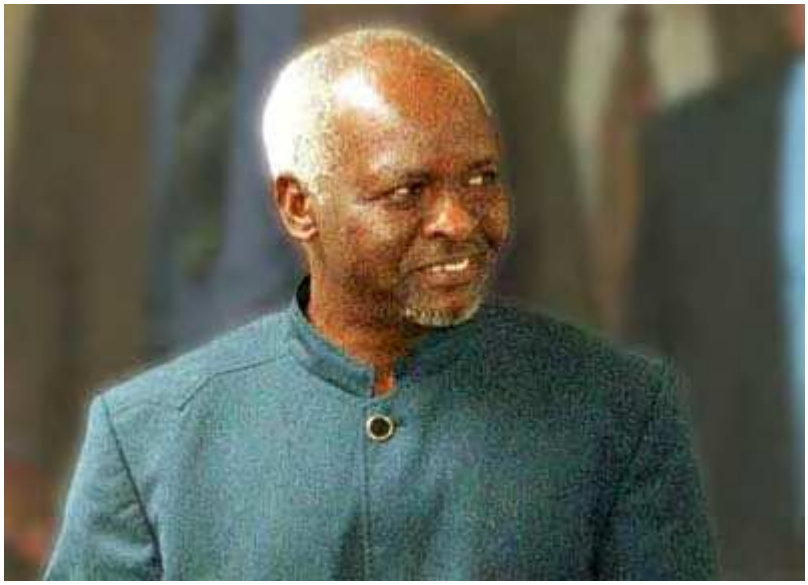
PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Canaan Banana

Nov 27th 2003
From The Economist print edition

AP



Canaan Banana, clergyman, politician and rapist, died on November 10th, aged 67

HIS life merits little more than a footnote in Zimbabwean history, but footnotes can be illuminating. Canaan Banana was Zimbabwe's first black president, serving as head of state for seven years after independence in 1980. It was a ceremonial post, however: real authority lay with the prime minister, Robert Mugabe.

For much of his time in office, President Banana's job was to look dignified at posh events, such as Prince Charles's wedding to Lady Diana Spencer. His light workload left him with plenty of time for his hobby, which was raping his male attendants. Though he lacked real power, he was quite powerful enough to torment underlings with impunity, despite the fact that homosexual acts are punishable by jail terms of up to ten years in Zimbabwe.

It was only when one of his victims killed a man that the story came out. In 1997, Jefta Dube, a former bodyguard who was on trial for murder, pleaded in mitigation that the man he shot had humiliated him by calling him “Banana's wife”. He told the court that while he was in Mr Banana's service in the mid-1980s, the president had repeatedly raped him. The first time, he said, Mr Banana played cards with him, drank with him and drugged him. He woke up on the carpet of the State House library with no trousers, and was greeted by a smiling president who said: “We helped ourselves.”

Mr Banana denied it, but several more accused him. A gardener, a cook, policemen and other flunkies recalled systematic abuse. An air force officer said he escaped Mr Banana's advances only by pushing him into a swimming pool. In 1998, Mr Banana was convicted of 11 counts of “sodomy” and “unnatural acts”. He fled the country before sentencing, apparently for fear that Mr Mugabe intended to have him killed. Nelson Mandela, then South Africa's president, persuaded him to return to Zimbabwe. He served eight months of a ten-year sentence, during which he was often allowed out shopping.

Even a little power corrupts

Canaan Sodindo Banana was born in 1936 near Bulawayo. He was educated at a mission school, and ordained as a Methodist minister in 1962. Before long, Reverend Banana became enthused with the

ideals of liberation politics, and started to denounce the white racist regime of what was then called Southern Rhodesia from the pulpit. He wrote an updated version of the Lord's Prayer, beginning “Our father who art in the ghetto” and including lines such as “Teach us to demand our share of the gold/Forgive us our docility/As we demand our share of justice.”

His preaching disturbed the authorities, but won him plaudits within the black liberation movement. At first he worked with Bishop Abel Muzorewa, a moderate but ineffectual liberation leader, but in 1976 he defected to Mr Mugabe's party, ZANU. When Zimbabwe became independent, ZANU picked him as its figurehead, partly because of his struggle credentials and partly because he was from the minority Ndebele tribe, whose members mostly supported Mr Mugabe's main rival, Joshua Nkomo.

As head of state, Mr Banana never really commanded respect. His name did not help, and in 1982 a law was passed banning jokes about it. While Mr Banana was president, Mr Nkomo fell out with Mr Mugabe, and a few hundred of Mr Nkomo's supporters took up arms against the regime. Mr Mugabe sent his best troops to crush the revolt, and to massacre between 10,000 and 20,000 Ndebele civilians suspected of supporting it.

While Mr Mugabe's men were systematically torturing his kin and torching their huts, Mr Banana said nothing. But he did help broker an accord between ZANU and Mr Nkomo's terrified party, ZAPU, to form a unity government in 1987. ZAPU was swallowed up, and Mr Banana was swept aside as Mr Mugabe created an overweeningly powerful executive presidency, and took the job himself.

Mr Banana doubtless expected to spend the rest of his life comfortably doing what people expect of retired statesmen. He led a mission from the World Council of Churches to apartheid South Africa, observed that country's constitutional convention on behalf of the Commonwealth, and tried to broker peace in Liberia on behalf of the Organisation of African Unity. The state looked after him well, providing him with a lavish tax-free pension, cars, servants and a lifetime exemption from import duty.

He thought he could get away with his crimes because ZANU politicians usually can. While president, he was at pains to present himself as a man of the people, dressing up in overalls and feeding his chickens for the cameras. But in private he had grander ideas of his station. When Mr Dube begged him to stop molesting him, he refused with the words: “I am the final court of appeal.”

After Mr Banana died, reportedly of cancer, he was denied the hero's burial that senior ruling-party hacks traditionally receive. Not because he was a rapist, but because he had been publicly revealed to be a homosexual shortly after Mr Mugabe had denounced such people as “worse than dogs and pigs”. In Zimbabwe, it is better to brutalise a hundred little people than to embarrass the president.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Overview

Nov 27th 2003
From The Economist print edition

The surge in **American** growth in the third quarter was revised up from an annual rate of 7.2% to 8.2%, the fastest for 20 years; this left GDP 3.5% higher than a year earlier. Business investment posted its biggest increase since the start of 2000, rising at an annual rate of 14%. American consumers are feeling a lot more optimistic: the Conference Board's confidence index rose by ten points to 91.7 in November, its highest for over a year. One reason is likely to be improving prospects for employment: new jobless claims fell to 351,000 last week, their lowest for almost three years. In another sign of the strengthening recovery, new orders for durable goods jumped by 3.3% in October.

The **euro** strengthened after the effective collapse of the stability pact on November 25th. The European Central Bank said that the decision to suspend sanctions carried “serious dangers”. However, the outlook for **Germany**, the euro area's biggest economy, improved for the seventh consecutive month, according to the Ifo business-climate index. The index for western Germany rose from 94.3 in October to 95.7 in November, the highest level for almost three years; businessmen in eastern Germany were more downbeat about economic prospects.

Elsewhere in the euro area, the **Spanish** economy grew at an annual rate of 2.9% in the third quarter, raising GDP by 2.4% on the same period a year ago. And the **Belgian** economy rebounded after shrinking in the second quarter. Output rose at an annual rate of 2% in the third quarter, a gain of 0.7% on a year ago. The Belgian central bank also reported that the improvement in business confidence which started this summer continued in November.

Britain's growth in the third quarter was revised up from an annual rate of 2.3% to 3.1%, the strongest for a year; GDP was 2% higher than in the same quarter in 2002. Strong consumer demand and a turnaround in inventories pushed the economy forward despite a fall in fixed investment and a drag from net trade. Growth was concentrated in construction and the services sector; manufacturing output was flat. However, manufacturers' order books improved sharply in November, according to the Confederation of British Industry's monthly survey.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Output, demand and jobs

Nov 27th 2003
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2003	2004	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 2.0	Q2	+ 0.5	+ 2.6	+ 3.7	+ 1.3	Q2	+ 5.3	Q3	5.6	Oct	6.0
Austria	+ 0.7	Q2	+ 1.1	+ 0.7	+ 1.8	+ 5.8	Mar	– 4.0	Aug	4.5	Sep	4.3
Belgium	+ 0.7	Q3	+ 2.0	+ 0.9	+ 1.8	– 2.9	Sep	– 3.6	Aug	12.9	Oct†	11.9
Britain	+ 2.0	Q3	+ 3.1	+ 2.0	+ 2.7	– 1.0	Sep	+ 3.7	Oct	5.0	Sep††	5.3
Canada	+ 1.6	Q2	– 0.3	+ 2.0	+ 3.0	– 2.1	Aug	+ 3.7	Aug	7.6	Oct	7.6
Denmark	– 1.0	Q2	– 2.2	+ 0.8	+ 2.0	+ 0.5	Sep	+ 3.4	Aug	6.4	Oct	5.3
France	– 0.1	Q3	+ 1.6	+ 0.2	+ 1.7	– 1.8	Sep	– 2.2	May	9.7	Sep	9.1
Germany	– 0.2	Q3	+ 0.9	nil	+ 1.6	– 3.6	Sep	– 3.1	Sep‡	10.5	Oct§	9.9
Italy	+ 0.5	Q3	+ 2.0	+ 0.4	+ 1.6	– 1.7	Sep	– 3.4	Aug	8.5	Jul	9.0
Japan	+ 2.3	Q3	+ 2.2	+ 2.6	+ 1.8	+ 4.1	Sep	– 1.8	Sep	5.1	Sep	5.4
Netherlands	– 1.1	Q3	+ 0.4	– 0.6	+ 1.1	– 1.2	Sep	– 7.4	Aug	5.4	Oct**	4.3
Spain	+ 2.4	Q3	+ 2.9	+ 2.2	+ 2.8	+ 2.0	Sep	+ 2.0	Aug	11.2	Sep	11.5
Sweden	+ 1.1	Q2	+ 1.1	+ 1.5	+ 2.3	+ 0.2	Sep	+ 3.8	Sep	5.1	Oct†	3.7
Switzerland	– 0.6	Q3	+ 1.0	– 0.5	+ 1.4	– 2.8	Q2	+ 2.7	Sep	3.8	Oct†	2.8
United States	+ 3.5	Q3	+ 8.2	+ 2.8	+ 3.9	+ 0.6	Oct	+ 8.3	Sep	6.0	Oct	5.8
Euro area	+ 0.3	Q3	+ 1.6	+ 0.4	+ 1.8	– 1.8	Sep	– 0.9	Aug	8.8	Sep	8.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 0.8	Q2	+ 2.4	na	na	+ 1.4	Sep	+ 5.3	Aug	8.3	Oct†	8.5
Greece	+ 4.5	Q2	+ 0.4	na	na	+ 2.1	Jul	na		na		na
Iceland	+ 2.7	Q2	na	na	na	– 0.3	2002	na		2.7	Sep†	2.2
Ireland	+ 2.1	Q2	na	na	na	– 2.7	Sep	+ 0.1	Sep	4.4	Oct	4.3
Luxembourg	+ 1.1	2002	na	na	na	+ 9.5	Aug	+ 1.2	Jun	3.9	Sep	3.0
New Zealand	+ 2.0	Q2	– 0.5	na	na	+ 2.5	Q2	+ 6.1	Q3	4.4	Q3	5.4
Norway	– 2.0	Q2	– 0.6	na	na	+ 3.7	Sep	+ 5.3	Sep	4.7	Q3	3.8
Portugal	– 2.3	Q2	+ 0.5	na	na	+ 2.3	Sep	– 0.3	Sep	6.3	Q3†	5.1

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Jul-Sep; claimant count rate 3% in Oct. §EU harmonised rate 9.4% in Sep. **Aug-Oct.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Prices and wages

Nov 27th 2003
From The Economist print edition

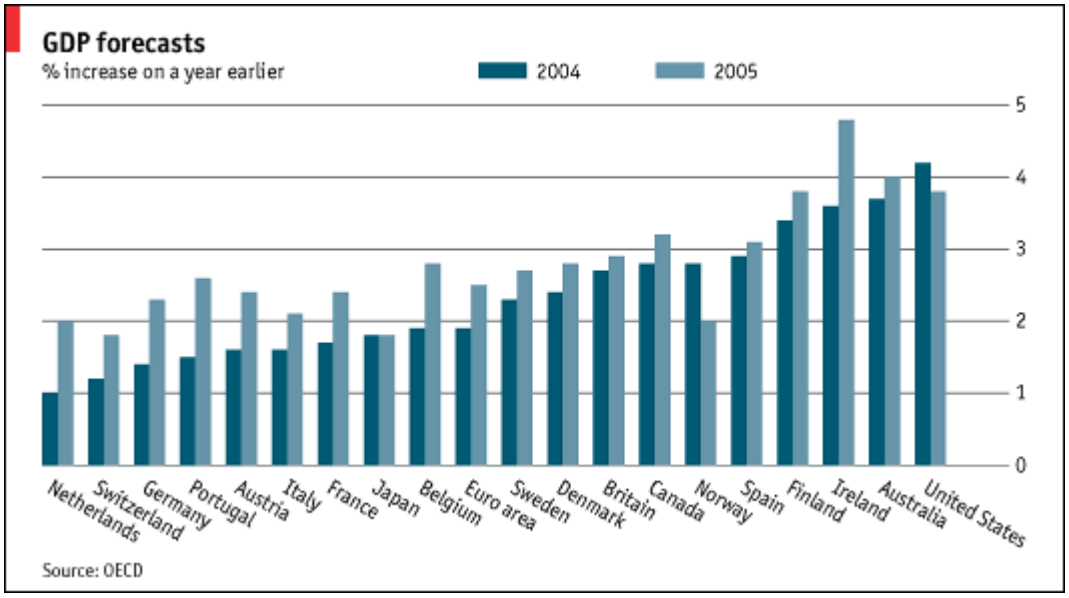
% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2003	2004	latest		year ago	latest		year ago
Australia	+ 2.6	Q3	+ 3.2	+ 2.7	+ 2.3	– 0.1	Q3	– 0.2	+ 5.1	Q3	+ 3.6
Austria	+ 1.0	Oct	+ 1.7	+ 1.3	+ 1.1	+ 2.0	Oct	+ 0.3	+ 2.3	Sep	+ 2.3
Belgium	+ 1.6	Oct	+ 1.3	+ 1.5	+ 1.3	– 0.9	Oct	+ 1.5	+ 1.9	Q3	+ 2.1
Britain	+ 2.6	Oct	+ 2.1	+ 2.7	+ 2.4	+ 1.4	Oct	+ 0.5	+ 3.6	Sep	+ 3.8
Canada	+ 1.6	Oct	+ 3.2	+ 2.7	+ 1.7	– 2.6	Sep	+ 0.6	+ 3.1	Aug	+ 2.7
Denmark	+ 1.4	Oct	+ 2.5	+ 2.2	+ 1.6	nil	Oct	+ 0.8	+ 3.6	Q3	+ 3.9
France	+ 2.2	Oct	+ 1.9	+ 2.0	+ 1.5	+ 0.3	Oct	+ 0.8	+ 3.0	Q3	+ 3.5
Germany	+ 1.3	Nov	+ 1.2	+ 1.1	+ 0.9	+ 0.8	Oct	+ 0.9	+ 2.0	Sep	+ 2.6
Italy	+ 2.6	Oct	+ 2.7	+ 2.7	+ 2.1	+ 1.0	Sep	+ 0.9	+ 2.6	Oct	+ 2.1
Japan	– 0.2	Sep	– 0.7	– 0.3	– 0.3	– 0.4	Oct	– 1.6	+ 1.3	Sep	+ 1.4
Netherlands	+ 2.0	Oct	+ 2.9	+ 2.3	+ 1.7	+ 1.1	Sep	+ 1.1	+ 2.3	Oct	+ 3.4
Spain	+ 2.6	Oct	+ 4.0	+ 3.1	+ 2.7	+ 0.6	Oct	+ 1.7	+ 4.2	Q2	+ 4.0
Sweden	+ 1.4	Oct	+ 2.5	+ 2.1	+ 1.7	– 1.5	Sep	– 0.7	+ 3.2	Aug	+ 2.9
Switzerland	+ 0.5	Oct	+ 1.3	+ 0.6	+ 0.5	– 0.3	Oct	– 0.7	+ 1.8	2002	+ 2.5
United States	+ 2.0	Oct	+ 2.0	+ 2.3	+ 1.4	+ 3.4	Oct	+ 0.7	+ 2.4	Oct	+ 3.1
Euro area	+ 2.0	Oct	+ 2.3	+ 2.0	+ 1.6	+ 1.1	Sep	+ 0.2	+ 2.9	Q2	+ 3.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.3	Oct	+ 1.5	na	na	– 0.9	Oct	+ 0.8	+ 4.3	Q2	+ 3.9
Greece	+ 3.3	Aug	+ 3.5	na	na	+ 2.2	Aug	+ 2.1	na		na
Iceland	+ 2.5	Nov	+ 2.4	na	na	+ 3.7	Oct	+ 6.2	+ 5.5	Oct	+ 5.9
Ireland	+ 2.3	Oct	+ 4.7	na	na	– 8.4	Oct	– 2.4	+ 8.7	Q2	+ 3.5
Luxembourg	+ 1.7	Oct	+ 2.2	na	na	+ 0.4	Sep	nil	+ 2.2	Aug	– 1.6
New Zealand	+ 1.5	Q3	+ 2.6	na	na	– 2.0	Q2	+ 1.5	+ 2.3	Q3	+ 2.3
Norway	+ 1.6	Oct	+ 1.8	na	na	+ 2.1	Oct	+ 4.4	+ 5.4	Q2	+ 4.9
Portugal	+ 3.0	Oct	+ 4.0	na	na	– 0.3	Sep	+ 0.1	– 2.1	Sep	+ 0.1

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

GDP forecasts

Nov 27th 2003
From The Economist print edition



A “palpable recovery” has taken hold across rich countries, according to the OECD's latest *Economic Outlook*. Overall, the OECD expects its member economies to grow by 3.0% in 2004 and 3.1% in 2005. That is up sharply from expected growth of 2.0% this year. Among the rich countries, America is likely to have the perkiest economy next year, with GDP growth of 4.2%. At the other extreme, the Netherlands is tipped to grow by only 1%.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Money and interest rates

Nov 27th 2003
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Nov 26th 2003)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 8.8	+12.9	Sep	5.35	4.84	5.60	5.85	5.52	6.53
Britain	+ 7.3	+ 7.4	Oct	3.91	3.94	4.52	4.38	4.67	5.70
Canada	+ 4.4	+ 5.7	Oct	2.67	2.73	3.18	4.38	5.19	6.33
Denmark	+ 9.0	+ 9.1	Oct	2.18	3.34	2.98	4.97	4.64	5.58
Japan	+ 5.6	+ 1.5	Oct	0.02	0.02	0.12	1.34	0.96	1.42
Sweden	+ 3.2	+ 4.9	Sep	2.70	3.79	3.18	4.89	5.01	3.91
Switzerland	+27.2	+ 9.8	Oct	0.25	0.75	0.08	2.80	2.53	2.65
United States	+ 7.0	+ 6.0	Oct	1.06	1.32	1.92	4.22	4.24	5.81
Euro area†	+12.5	+ 8.0	Oct	2.15	3.05	2.68	4.35	4.48	4.23

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 5.07%, Japan No. 255 1.32%. Central bank rates: US fed funds 1.00%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 3.75%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The Economist commodity price index

Nov 27th 2003
From The Economist print edition

1995=100

	Nov 18th	Nov 25th*	% change on one month	% change on one year
Dollar index				
All items	87.9	86.6	+ 0.7	+13.8
Food	87.6	85.9	+ 0.4	+ 8.1
Industrials				
All	88.2	87.5	+ 1.3	+22.5
Nfa†	91.5	90.2	– 0.5	+22.9
Metals	85.3	85.3	+ 2.8	+22.2
Sterling index				
All items	81.6	80.5	+ 0.6	+ 4.7
Euro index				
All items	97.2	96.6	– 0.2	– 4.2
Yen index				
All items	101.2	101.1	+ 2.0	+ 2.5
Gold				
$ per oz	396.25	392.25	+ 2.2	+23.2
West Texas Intermediate				
$ per barrel	33.18	29.75	+ 0.8	+12.6

* Provisional. † Non-food agriculturals.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Stockmarkets

Nov 27th 2003
From The Economist print edition

Market indices

	Nov 26th	2003 high	2003 low	% change on one week	% change on record high	% change on Dec 31st 2002 in local currency	% change on Dec 31st 2002 in $ terms
Australia (All Ordinaries)	3,198.7	3,310.6	2,673.3	+ 0.3	– 7.0	+ 7.5	+38.2
Austria (ATX)	1,466.4	1,459.8	1,120.2	+ 0.5	–15.6	+27.5	+44.8
Belgium (Bel 20)	2,166.9	2,203.4	1,426.6	+ 0.7	–41.1	+ 7.0	+21.5
Britain (FTSE 100)	4,370.3	4,397.0	3,287.0	+ 1.0	–36.9	+10.9	+17.7
Canada (Toronto Composite)	7,860.4	7,870.9	6,228.6	+ 0.8	–31.0	+18.8	+44.1
Denmark (KBX)	211.2	222.6	145.0	– 1.5	–30.0	+27.0	+44.1
France (SBF 250)	2,342.7	2,358.4	1,630.1	+ 2.4	–46.6	+14.1	+29.6
(CAC 40)	3,415.2	3,453.1	2,403.0	+ 2.1	–50.7	+11.5	+26.6
Germany (DAX)	3,713.0	3,797.4	2,203.0	+ 1.7	–54.0	+28.4	+45.8
Italy (BCI)	1,259.2	1,246.8	959.4	+ 2.4	–42.3	+15.3	+31.0
Japan (Nikkei 225)	10,144.8	11,161.7	7,607.9	+ 5.5	–73.9	+18.3	+28.6
(Topix)	1,002.0	1,105.6	770.6	+ 5.1	–65.3	+18.8	+29.2
Netherlands (AEX)	332.3	343.0	218.4	+ 1.6	–52.6	+ 3.0	+17.0
Spain (Madrid SE)	766.6	774.1	576.8	+ 1.2	–33.1	+20.9	+37.4
Sweden (Affarsvarlden Gen)	181.2	186.3	127.8	+ 0.4	–54.7	+24.8	+43.6
Switzerland (Swiss Market)	5,296.0	5,422.6	3,675.4	+ 1.9	–37.0	+14.4	+21.8
United States (DJIA)	9,779.6	9,858.5	7,524.1	+ 0.9	–16.6	+17.2	+17.2
(S&P 500)	1,058.5	1,059.0	800.7	+ 1.5	–30.7	+20.3	+20.3
(NASDAQ Comp)	1,953.3	1,976.4	1,271.5	+ 2.8	–61.3	+46.3	+46.3
Europe (FTSE Eurotop 300)*	931.1	941.5	682.7	+ 1.7	–45.4	+ 8.6	+23.4
Euro area (FTSE Ebloc 100)*	797.4	808.8	565.7	+ 1.7	–48.6	+11.0	+26.1
World (MSCI)†	974.7	972.7	710.8	+ 1.8	–32.7	+23.0	+23.0
World bond market (Citigroup)‡	580.5	583.9	518.6	– 0.1	– 0.6	+10.5	+10.5

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Trade, exchange rates and budgets

Nov 27th 2003
From The Economist print edition

	Trade balance*, $bn latest 12 months	Current account $bn latest 12 mths	Current account The Economist poll % of GDP, forecast 2003	Current account The Economist poll % of GDP, forecast 2004	Exchange rate trade-weighted† 1990=100 Nov 26th	Exchange rate trade-weighted† 1990=100 year ago	Currency units per $ Nov 26th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2003‡
Australia	− 13.5 Sep	− 24.4 Q2	− 5.6	− 4.9	86.5	74.2	1.38	1.80	2.35	1.65	1.27	0.8
Austria	− 0.6 Aug	+ 0.5 Sep	nil	− 0.1	102.6§	100.8	0.84	1.01	1.43	–	0.77	-1.3
Belgium	+ 20.7 Sep	+ 11.2 Jun	+ 4.7	+ 4.8	102.6§	100.0	0.84	1.01	1.43	–	0.77	0.2
Britain	− 73.9 Sep	− 28.6 Q2	− 1.7	− 1.5	100.2	105.0	0.59	0.65	–	0.70	0.54	-2.9
Canada	+ 41.5 Sep	+ 14.7 Q2	+ 1.7	+ 1.4	88.9	75.4	1.30	1.58	2.21	1.55	1.19	1.0
Denmark	+ 9.7 Sep	+ 5.3 Sep	+ 2.7	+ 2.7	106.2	103.1	6.24	7.50	10.6	7.44	5.72	0.8
France	+ 5.6 Sep	+ 20.6 Sep	+ 1.4	+ 1.4	106.0§	102.9	0.84	1.01	1.43	–	0.77	-4.0
Germany	+137.2 Sep	+ 56.4 Sep	+ 2.0	+ 2.0	103.5§	99.9	0.84	1.01	1.43	–	0.77	-4.1
Italy	+ 1.6 Sep	− 20.9 Sep	− 0.8	− 0.7	75.6§	73.4	0.84	1.01	1.43	–	0.77	-2.7
Japan	+ 97.7 Sep	+123.3 Sep	+ 2.8	+ 2.9	136.5	132.6	109	122	185	130	–	-7.4
Netherlands	+ 31.5 Sep	+ 17.7 Q3	+ 2.3	+ 2.6	102.1§	99.1	0.84	1.01	1.43	–	0.77	-2.4
Spain	− 49.2 Aug	− 23.1 Aug	− 2.4	− 2.2	76.9§	75.0	0.84	1.01	1.43	–	0.77	0.1
Sweden	+ 17.8 Oct	+ 14.8 Q3	+ 4.1	+ 4.1	82.0	78.4	7.53	9.15	12.8	8.98	6.90	0.2
Switzerland	+ 6.0 Oct	+ 35.0 Q2	+11.0	+11.0	111.8	113.9	1.30	1.49	2.21	1.55	1.19	na
United States	−542.6 Sep	−528.7 Q2	− 5.1	− 5.3	97.6	114.0	–	–	1.70	1.19	0.92	-4.9
Euro area	+ 84.3 Sep	+ 36.8 Sep	+ 0.4	+ 0.5	90.4	82.4	0.84	1.01	1.43	–	0.77	-2.7
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 13.7 Sep	+ 10.0 Sep	na	na	81.5§	79.0	0.84	1.01	1.43	–	0.77	2.6
Greece	− 24.7 Sep	− 10.7 Sep	na	na	59.2§	58.0	0.84	1.01	1.43	–	0.77	-1.6
Iceland	− 0.1 Sep	− 0.2 Q2	na	na	95.0**	93.0	75.1	86.3	128	89.6	68.9	-1.0
Ireland	+ 37.5 Aug	− 2.1 Q2	na	na	94.2§	89.1	0.84	1.01	1.43	–	0.77	-1.0
Luxembourg	− 3.3 Aug	+ 1.5 Q2	na	na	102.6§	100.0	0.84	1.01	1.43	–	0.77	-0.3
New Zealand	− 1.7 Sep	− 2.9 Q2	na	na	102.8	89.8	1.57	2.03	2.67	1.87	1.44	2.6
Norway	+ 28.0 Oct	+ 27.0 Aug	na	na	98.4	106.8	6.85	7.33	11.6	8.17	6.28	9.8
Portugal	− 12.9 Aug	− 7.8 Aug	na	na	93.6**	91.2	0.84	1.01	1.43	–	0.77	-2.9

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, September average. ‡OECD forecast. **IMF, July average.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The Economist food index

Nov 27th 2003
From The Economist print edition

Our dollar-based food index has hit a five-year high. Beef prices are at a record and soyabeans at a six-year high, due to America's drought. Only sugar and cocoa prices have fallen this year.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Overview

Nov 27th 2003
From The Economist print edition

South Korea's economy recovered in the third quarter, after two quarters of contraction. Its GDP was 2.3% higher than a year earlier. Exports were the main driver of growth, rising by 15.2% over the year. Foreign-exchange reserves increased to $143 billion in October, up by 23% on a year earlier.

Consumer prices in **Hong Kong** fell by 2.7% in the year to October. The country has now suffered deflation for five years.

Venezuela's GDP fell by 7.1% in the year to the third quarter, its seventh consecutive quarter of annual decline. A bitter political conflict and an oil strike early this year have severely depressed the economy.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Digital access index

Nov 27th 2003
From The Economist print edition

The International Telecommunication Union's new “digital access index” ranks access to information and communication technologies in different countries. Each country's ranking depends on affordability of access, level of education, quality of services and level of internet use, in addition to availability of infrastructure. The ITU says lack of infrastructure is no longer the limiting factor in extending access.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economy

Nov 27th 2003
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.1	Q3	+17.2	Oct	+ 1.8	Oct	+20.6	Oct	+35.4	2002	383.9	Sep
Hong Kong	– 0.5	Q2	–12.5	Q2	– 2.7	Oct	– 7.7	Oct	+18.4	Q2	112.4	Oct
India	+ 5.7	Q2	+ 6.5	Sep	+ 2.9	Sep	–12.4	Sep	+ 2.8	Q2	88.7	Oct
Indonesia	+ 3.9	Q3	+ 4.7	Jul	+ 6.2	Oct	+26.1	Sep	+ 6.7	Q1	33.5	Oct
Malaysia	+ 3.5	Q3	+ 9.7	Sep	+ 1.3	Oct	+17.6	Sep	+10.1	Q2	39.7	Oct
Philippines	+ 4.4	Q3	– 3.7	Sep	+ 3.1	Oct	– 1.4	Sep	+ 2.8	Jul	13.5	Oct
Singapore	+ 1.7	Q3	+ 6.3	Sep	+ 0.6	Oct	+17.4	Oct	+25.6	Q3	92.5	Oct
South Korea	+ 2.3	Q3	+ 6.6	Sep	+ 3.7	Oct	+12.8	Oct	+ 8.0	Oct	143.2	Oct
Taiwan	+ 4.2	Q3	+ 9.0	Oct	– 0.1	Oct	+19.0	Oct	+28.8	Q3	196.6	Oct
Thailand	+ 5.8	Q2	+10.5	Sep	+ 1.2	Oct	+ 4.6	Sep	+ 8.5	Sep	39.3	Oct
Argentina	+ 7.6	Q2	+10.8	Sep	+ 3.9	Oct	+17.3	Sep	+10.2	Q2	13.4	Sep
Brazil	– 1.3	Q2	+ 4.2	Sep	+14.0	Oct	+23.4	Oct	+ 3.7	Oct	52.7	Sep
Chile	+ 3.0	Q3	+ 5.8	Sep	+ 1.2	Oct	+ 2.6	Oct	– 0.3	Q3	15.7	Oct
Colombia	+ 4.0	Q3	+ 5.6	Sep	+ 6.6	Oct	– 0.1	Aug	– 1.7	Q2	10.5	Oct
Mexico	+ 0.4	Q3	– 0.6	Sep	+ 4.0	Oct	– 6.0	Oct	–11.5	Q2	56.2	Oct
Peru	+ 3.6	Sep	+ 2.6	Sep	+ 1.3	Oct	+ 0.4	Sep	– 1.2	Q3	9.1	Oct
Venezuela	– 7.1	Q3	–13.6	Aug	+25.6	Oct	+14.6	Q2	+ 8.9	Q3	14.5	Sep
Egypt	+ 3.1	2003†	+ 4.2	2002†	+ 4.5	Aug	– 7.1	Mar	+ 1.9	Q2	13.4	Jul
Israel	+ 2.8	Q3	+ 6.0	Sep	– 2.6	Oct	– 6.4	Oct	nil	Q2	24.9	Oct
South Africa	+ 1.6	Q3	– 3.6	Sep	+ 1.5	Oct	+ 3.2	Sep	– 0.9	Q2	6.5	Sep
Turkey	+ 3.9	Q2	+12.7	Sep	+20.8	Oct	–20.4	Sep	– 4.7	Aug	32.9	Oct
Czech Republic	+ 2.1	Q2	+ 5.2	Sep	+ 0.4	Oct	– 2.3	Oct	– 5.0	Q2	25.6	Oct
Hungary	+ 2.4	Q2	+ 5.6	Sep	+ 4.9	Oct	– 3.9	Sep	– 5.3	Sep	12.5	Oct
Poland	+ 3.8	Q2	+12.1	Oct	+ 1.3	Oct	–10.2	Oct	– 4.8	Sep	32.5	Oct
Russia	+ 7.2	Q2	+ 7.2	Oct	+13.1	Oct	+56.4	Sep	+37.9	Q3	61.2	Oct
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 3.5	Q2	+ 9.1	Oct	+ 1.0	Oct	– 1.8	Sep	– 1.5	Q3	1.2	Sep
Latvia	+ 6.2	Q2	+ 9.4	Sep	+ 3.3	Oct	– 1.9	Sep	– 0.9	Sep	1.4	Sep
Lithuania	+ 8.4	Q3	na		– 1.4	Oct	– 2.4	Sep	– 0.9	Q2	2.8	Sep
Slovakia	+ 3.8	Q2	+ 3.9	Sep	+ 9.6	Oct	– 1.2	Sep	+ 1.1	Jul	10.0	Sep
Slovenia	+ 2.1	Q2	+ 0.9	Sep	+ 4.8	Oct	– 0.5	Aug	+ 0.1	Sep	7.6	Aug
Pakistan	+ 5.1	2003†	+ 7.2	Jun	+ 3.5	Oct	– 1.2	Oct	+ 3.6	Q3†	9.9	Sep
Saudi Arabia	+ 1.0	2002	na		– 1.2	Jul	+41.8	2002	+11.9	2002	22.4	Sep

*Excluding gold, except Singapore; IMF definition. †Year ending June.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Financial markets

Nov 27th 2003
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Nov 26th		Dec 31st 2002	
	Nov 26th	year ago	Nov 26th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	14.1	na	1,477.3	+5.5	+ 4.1	+ 4.1
Hong Kong	7.77	7.80	13.3	0.31	12,086.7	+1.8	+ 29.7	+ 30.2
India	45.9	48.2	78.4	4.94	4,894.6	+1.5	+ 44.9	+ 51.5
Indonesia	8,517	8,935	14,556	8.85	617.1	+2.5	+ 45.2	+ 52.6
Malaysia	3.80	3.80	6.49	3.03	784.5	+2.4	+ 21.4	+ 21.4
Philippines	55.5	53.6	94.9	8.56	1,344.4	+2.0	+ 32.0	+ 27.0
Singapore	1.72	1.76	2.95	0.75	1,688.4	+0.7	+ 25.9	+ 26.7
South Korea	1,203	1,195	2,055	4.27	783.0	+1.5	+ 24.8	+ 23.1
Taiwan	34.1	34.7	58.3	1.05	5,860.6	−0.1	+ 31.6	+ 34.1
Thailand	39.9	43.4	68.2	1.40	630.8	+1.9	+ 77.0	+ 91.1
Argentina	2.95	3.48	5.04	4.50	990.0	+7.5	+ 88.6	+115.3
Brazil	2.94	3.59	5.03	17.35	19,694.8	+4.7	+ 74.8	+110.4
Chile	624	707	1,067	2.76	7,149.2	nil	+ 42.4	+ 64.3
Colombia	2,839	2,755	4,852	7.95	2,217.0	−0.2	+ 37.8	+ 39.2
Mexico	11.4	10.2	19.4	5.78	8,385.4	+0.4	+ 36.9	+ 26.1
Peru	3.48	3.54	5.95	2.45	2,141.7	+1.9	+ 53.9	+ 55.3
Venezuela	1,598	1,320	2,731	16.00	21,145.2	+5.0	+163.8	+128.9
Egypt	6.15	4.63	10.50	6.89	11,094.3	−0.6	+106.5	+ 55.6
Israel	4.47	4.64	7.63	2.47	506.6	+0.6	+ 52.4	+ 62.1
South Africa	6.42	9.30	11.0	7.60	9,601.3	−0.6	+ 3.5	+ 38.3
Turkey	1,470,000	1,563,950	2,512,377	25.00	14,617.5§	−7.4	+ 41.0	+ 59.2
Czech Republic	26.8	31.2	45.8	2.07	624.4	−0.5	+ 35.5	+ 52.1
Hungary	220	239	375	10.28	9,205.8	−3.0	+ 18.0	+ 20.9
Poland	3.92	3.99	6.69	5.76	19,056.0	−1.4	+ 32.6	+ 29.9
Russia	29.7	31.9	50.8	16.00	540.9‡	+12.5	+ 40.2	+ 50.6
EMF (MSCI)*	1.00	1.00	1.71	na	408.9	+1.1	+ 40.0	+ 40.0
EMBI+†	1.00	1.00	1.71	na	286.6	+0.6	+ 25.2	+ 25.2

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡ In $ terms. § November 20th

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.